



What the Retail Payment Activities Act means for payment services

The COVID-19 pandemic accelerated digital payment use, leading to peaks in contactless and e-commerce transactions. Payment service providers (PSPs) are now challenging traditional payment facilitators—playing an increasingly important role in responding to consumer and merchant demands for more intuitive and straightforward money transfer experiences.



Executive summary

Existing payment regulations in Canada are heavily focused on governing prominent national payment systems, such as the Interac network and the Automated Clearing Settlement System (ACSS). Through the Retail Payment Activities Act (RPAA), the Bank of Canada (BoC) is supporting the development of a retail payment supervisory framework, which aims to regulate eligible PSPs to become Payments Canada members and participants.¹ The intention of this new regulatory regime is to build confidence in the retail payment sector by helping ensure that PSPs are more effectively regulated. This will preserve the safety and reliability of the payment ecosystem while fostering efficiency and innovation.

PSPs are showing support for the introduction of the RPAA as a key step toward direct access to Canada's future Real-Time Rail (RTR) payments system. The RPAA's key provisions cover:

- Risk management
- Incident response and reporting
- Fund safeguarding
- Registration
- Record keeping and retention
- Administration and enforcement

Specifically, the PSPs overseen by the RPAA—those eligible for membership through Payments Canada and that meet specific requirements—may have access to the future RTR payment system. Of course, larger and ubiquitous PSPs may consider smaller providers gaining direct access in this way as introducing additional risk to the ecosystem. How well positioned the PSPs are to meet the requirements remains to be seen. However, we anticipate that many PSPs can expect to face significant challenges in meeting the RPAA regulatory expectations for operational risk incident management, reporting, and record-keeping requirements.

Public consultations on the RPAA draft were held from February 11 to March 28, 2023. Consulting with key industry stakeholders throughout the BoC's drafting process provided PSPs the opportunity to review the draft in detail and offer feedback, including on where additional clarity may be helpful. Continued collaboration between regulators, government, PSPs, and industry is essential to encourage dialogue and feedback as the RPAA is implemented—and helps shape the future of payments in Canada.

Throughout the new framework's design, implementation, compliance, and enforcement process, key areas of discussion and outstanding questions that stakeholders have welcomed and engaged in include the following:

Scope

- What levels of supervision will the BoC oversee for PSPs of varying sizes?
- How will the BoC adopt the principle of proportionality in its supervisory approach?

Standardization across PSPs

- What are the supervisory expectations for centralized, standardized, mature governance, and risk management capabilities across all PSPs, irrespective of their size and business models?

Implications

- How will interactions between PSPs and the regulator evolve, and how can these be structured for collaboration?
- What administrative and compliance cost implications might applicable PSPs face over the next few years?

The intent of this paper is to explore these questions and identify the key elements necessary to ensure PSP compliance with RPAA regulations. Lessons learned from jurisdictions that have statutes similar to the RPAA will also be considered to help inform how PSPs may best prepare for supervision.

Recent global developments

Resilient payment systems are crucial, as negative incidents can adversely affect the stability of large-scale financial systems and national economies. Canadian regulators, along with their global counterparts and central banks, have been enhancing mandates based on new innovations in the payment ecosystem, including buy-now and pay-later offerings, digital currencies, and other electronic payment activities. There have been several recent global developments intended to help regulate retail PSPs.

- **European Union, January 2016**

The revised Payment Services Directive (PSD2)² seeks to make payments more secure in Europe, boost innovation, help banking services adapt to new technologies, and acknowledges the increasing importance application program interfaces (APIs).

- **United Kingdom, July 2017**

The Payment Services Regulations 2017 aim to foster greater competition and innovation, as well as a stronger and more competitive UK payment sector.

- **Australia, June 2019**

Recommendations by the Reserve Bank of Australia for amending the New Payments Platform (NPP) regulations aim to allow entities that are not authorized deposit-taking institutions (ADIs) the possibility of becoming direct participants.³ The NPP initiative, like the RTR in Canada, provides industry-regulated open access infrastructure for fast payments with richer data, simpler routing, and better availability.

- **United States, March 2022**

An update of the Federal Reserve Board's guidance on payment system access introduces a three-tiered approach that the 12 Federal Reserve Banks could use to analyze requests for this access. The 2022 guidelines also signal the Federal Reserve's intent to further stratify tier payment system access requests.

Challenges that PSPs have been facing globally include:

- **Heightened regulatory scrutiny on the payment industry**

Addressing the potential national security risks posed by presently unregulated PSPs is among the policy objectives of the RPAA. This underscores the need for PSPs to focus on how to sustainably set out and manage regulatory compliance obligations.

- **Overlapping regulatory requirements:**

Supervisory bodies are becoming more closely connected globally, which has led to overlap in their regulations and, as such, increased challenges for entities that operate across borders in distinguishing and adhering to multiple edicts. To address this point, the BoC has been consulting with foreign regulators and international PSPs to help ensure regulatory alignment across jurisdictions.

- **Increasing data requirements:**

PSPs have been tasked with collecting ever more granular data to respond to regulatory inquiries, leading to increasingly complex onboarding requirements and a heavier burden for data storage.

PSPs that adapt their operating models to accommodate regulatory overlaps and streamline their monitoring and compliance efforts will greatly benefit from the upcoming revisions and updates to regulations.



Overview of Canadian payment regulations

The rapid growth of the payment industry, which has facilitated the development of innovative products that are more aligned with consumers' increasingly digital lifestyles, has challenged traditional payment methods. Additionally, the financial services ecosystem has become more complex with the addition of new payment infrastructures and arrangements. As a result, businesses and consumers are increasingly exposed to new and emerging risks like fraud, cybercrime, identity theft, etc.

The BoC aims to increase its attention on the payment space alongside Payments Canada—which owns and operates the country's payment clearing and settlement infrastructure. With Payments Canada's impending introduction of the RTR system as well as the RPAA draft regulations as a new requirement, industry supervisors are looking to continue fostering innovation and strengthening Canada's competitive position in the global arena.

A key focus of the BoC is to implement a retail payment supervision (RPS) mandate. Currently, PSPs such as card networks, payment processors, and digital wallets are overseen by regulations including but not limited to the following:

- Payments Clearing and Settlement Act
- Bills of Exchange Act
- Payment Card Networks Act
- Canada's anti-spam legislation
- Personal Information Protection and Electronic Documents Act (PIPEDA)
- Competition Act
- Code of Conduct for the Credit and Debit Card Industry in Canada
- Payment Card Industry Data Security Standard (PCI DSS)
- Payments Canada rules and bylaws
- Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA) and Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) requirements

These regulations help address general business practices, promote transparency between institutions, and combat money laundering and terrorist-activity financing.

With the RPAA, the BoC intends to address existing gaps that are presently not fully covered by Canadian regulations to achieve the following goals and objectives:



Increase competition, security, and volume of payments

Improve security—owing to increased competition and volume of payments in the ecosystem—allowing for PSP growth.



Provide risk-based oversight

Focus on end user impacts and the efficiency of payment services to assess the level of risk each PSP brings to consumers and the payment ecosystem. The BoC will maintain a public list of all registered PSPs. This also entails implementing policies to monitor and evaluate retail payment trends and issues.



Under the **RPAA**, PSPs are defined as any individual or entity that performs one or more payment functions as a service or business activity that is not incidental to another such service or activity.

Introduction to the RPAA

The RPAA aims to introduce a new set of regulatory requirements for retail PSPs in Canada. Its draft regulations—set to come into force in 2024—are prescriptive in terms of expectations for registered PSPs, especially regarding operational risk management, incident response, safeguarding of funds, and reporting. Under the RPAA, PSPs are defined as any individual or entity that performs one or more payment functions as a service or business activity that is not incidental to another such service or activity.

The following is an overview of RPAA regulations, including those related to electronic funds transfer (EFT) payments.

Scope of the RPAA:

- Payment functions related to EFTs from one end user to another, using a PSP
- All payment activities of PSPs with a place of business in Canada
- Payment activities of foreign PSPs that the PSP directs to and performs for end users in Canada

The five payment functions of PSPs regulated by the act are:

1. **Provision or maintenance of a payment account** (e.g., a third-party application provider linked to an end user's payment account to simplify payments without the user having to access this account through a mobile banking application or perform transactions using a banking card)
2. **Holding of end user funds** until withdrawn by the end user or transferred to another individual or entity
3. **Initiation of a payment via an EFT** at the request of an end user
4. **Authorization for an EFT** or the transmission, reception, facilitation of payment messages
5. **Provision of clearing or settlements**

Introduction to the RPAA—continued

Key provisions under the RPAA

1. Risk management and incident response

- Comply with operational and financial measures for financial market infrastructures
- Establish, implement, and maintain risk management and incident response frameworks
- Comply with provincial consumer protection legislation in provinces where services are offered, with no obligations around complaint handling. As part of its risk management framework, a PSP will be required to conduct detailed operational assessments of its third-party service providers at least annually and prior to renewing or entering into any significant amendments to its third-party servicing contracts
- Manage risks from third-party service providers, agents, and mandataries

2. Safeguarding of funds

- Hold funds until end user withdraws or transfers them

3. Reporting

- Report to the BoC using the channel designed for the specific document (e.g., annual report, incident report, significant change report); applies to registered PSPs

4. Registration

- Apply for registration with the BoC before performing retail payment activities (applies to current and new PSPs)
- The BoC is to maintain a public registry of PSPs, including those whose registration was refused or revoked

5. Record-keeping and retention

- Maintain sufficient records to demonstrate PSP compliance with the RPAA

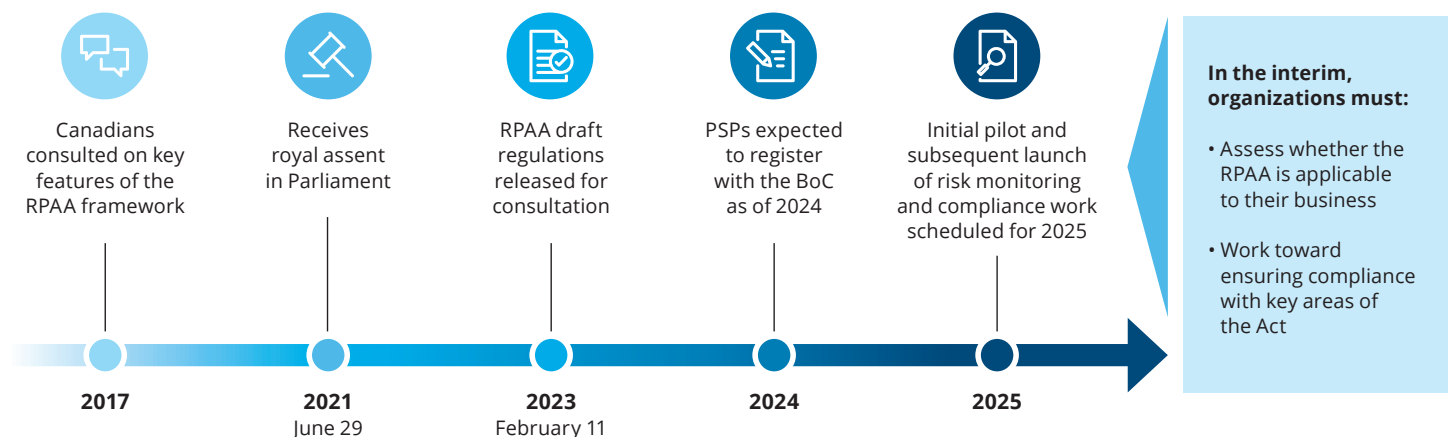
6. Administration and enforcement

- PSP registration fee of \$2,500 for the first year the RPAA is in force
- Applicable annual assessment fee
 1. Base amount of equally distributed costs to all registered PSPs
 2. Metric-driven amount where the remainder of costs will be proportionally distributed to all registered PSPs based on their share of retail payment activity
- Fee adjustments each subsequent year
- Non-monetary and monetary penalties: (a) up to \$1,000,000 in the case of a serious violation; and (b) up to \$10,000,000 in the case of a very serious violation, with exceptions noted

Key exclusions under the RPAA

- Canadian and authorized foreign banks
- Financial institutions that are not federally regulated, such as provincial credit unions and caisses populaires
- Incidental retail payment activities, such as:
 - Internal transactions between affiliated entities
 - EFT payments made with instruments issued by a merchant (or by an agent affiliated with merchant groups), and that allow the instrument holder to purchase goods or services (such as closed-loop gift cards) from the issuing merchant or group alone
 - EFT payments performed by securities dealers to implement prescribed securities transactions
 - Transactions involving the Society for Worldwide Interbank Financial Telecommunication (SWIFT) global messaging network

The timelines outlined in the RPAA framework mark an important step forward in the regulation of PSPs, as well as in broadening participation in Canada's retail payment systems. The following graphic provides an overview of these timelines.



Implications of the RPAA

The introduction of the RPAA brings additional compliance challenges and financial considerations for PSPs. Whether they are large and ubiquitous or emerging and smaller, PSPs may need to adjust their expense structures to maintain healthy margins between conducting business as usual and ensuring RPAA compliance.

As noted, the RPAA draft outlines the payment functions to be overseen by the regulations, and details how different PSPs can expect to be affected based on their product offerings. The following are key points for PSPs to consider as the RPAA is rolled out and the new regulations come into effect:

- **Assess the PSP's role in overall ecosystem**

A PSP's role in the overall ecosystem will affect its operations under the new regulations. Each of the five PSP payment functions to be regulated by the RPAA is associated with different profit margins and expense structures; therefore, compliance may affect different PSPs to varying degrees.

- **Re-evaluate existing risk and compliance frameworks**

It remains to be seen how well positioned PSPs are to adapt to RPAA regulations given their current state—this will naturally vary by PSP. For some, additional resources and efforts may be required to identify and address gaps between their current state practices and the new regulations. PSPs may need to assess their policies and consider whether they can absorb these additional costs or if they'll need to pass these costs on to their clients.

- **Create a road map for the future**

PSPs should establish a road map for creating sustainable internal policy risk and compliance frameworks to align with the regulations. This will pave the way to reduce reliance on third parties for direct access.

- **Comply within timelines**

We believe emerging PSPs may encounter delays in their projected market entry timelines as they work to ensure their risk management frameworks are sufficiently sophisticated to satisfy the new regulations. Businesses would need to allocate sufficient resources to assess any current or projected risks, and then adapt their operations to identify, manage, and mitigate these risks within the timelines.

- **Manage non-compliance**

Further, the monetary and non-monetary penalties outlined for RPAA violations—reaching \$1 million to \$10 million for serious infractions—may affect an entity's financial ability to continue operations if found to be non-compliant. The BoC will maintain a public registry of PSPs whose registration was refused or revoked. The possibility of fines may also spur mergers for players that would not be able to afford compliance costs.

Thus, overall, a PSP's structure, risk culture, and governance needs to be assessed to ensure compliance with the RPAA regulations.

Preparing for the RPAA



With consultations on the draft regulations having been completed, the time to begin preparing for implementation is now. The race will no doubt go to the nimble and well-informed—the leaders and fast followers with the information and insights to move quickly on smart, well-executed strategies. The PSPs expected to be affected by the new rules may face regulatory hurdles as they work to meet RPAA requirements.

To prepare for the introduction of these new regulations, PSPs can consider taking the following steps:

- Assess whether there are gaps between current practices and draft regulation requirements to determine the level of effort that may be needed to meet the new obligations. Institutions that operate in other jurisdictions may require an additional step to assess similarities and overlaps between RPAA regulations and those of other governing bodies, and then may need to determine whether additional adherence or streamlining efforts may be beneficial.
- Establish a road map and take a risk-based approach in addressing any gaps, and then implement changes required, such as modifying the company's operating model to facilitate ongoing compliance needs and updating organizational design to help drive efficiencies.
- Determine key regulatory relationships and develop plans for stakeholder engagement and communication.

As organizations embark on the RPAA journey, these practical levers for change can help ensure their success:

- Governance and accountability:
 - Instilling a commitment to enterprise-wide risk compliance, reinforced through risk-reward processes and governance
 - Establishing channels for reporting and escalating issues to senior management and boards
 - Assessing staff to ensure resources are sufficient and skills are properly allocated
 - Focusing on business-wide and customer-specific strategy

- In case any incidents are observed, PSPs should have a clear plan with roles and responsibilities defined for responding to, recovering from incidents, including those involving or detected by an agent, mandatory or a third-party service provider
- Data analytics and technology:
 - Using internal data to its full impact and enhancing technology to help ensure relevant data can be obtained across functions, businesses, and entities
 - Identify all assets including systems, data and information, and business processes that are associated with a PSP's performance of retail payment activities and classify them according to their sensitivity and criticality
 - Ensuring the availability of PSP's retail payment activities and of the systems, and information involved in the provision of those activities at least a year before the regime goes live in mid-2025
 - In case any incidents are observed, PSPs should have an understanding of the expected outcome of its possible or verified impact on systems, data, or information involved in the performance of retail payment activities
 - Prioritizing investments in modernized technology to maximize enterprise-wide continual integration and compliance

Registering with the BoC is a core component of the new regulations; PSPs should consider this as an important first step to continue their operations and product offerings for Canadian users.

As the RPAA is finalized, it is important for PSPs to remain aware of any updates to the draft legislation, assess how any new and emerging regulations and guidance may affect their organization, and work to achieve and maintain compliance.

Endnotes

1. Government of Canada, "Retail Payment Activities Act," *Justice Laws Website*, accessed March 16, 2023, <https://laws-lois.justice.gc.ca/eng/acts/R-7.36/page-1.html>.
2. "The revised *Payment Services Directive* (PSD2) and the transition to stronger payments security," *European Central Bank*, March 2018, https://www.ecb.europa.eu/paym/intro/mip-online/2018/html/1803_revisedpsd.en.html.
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