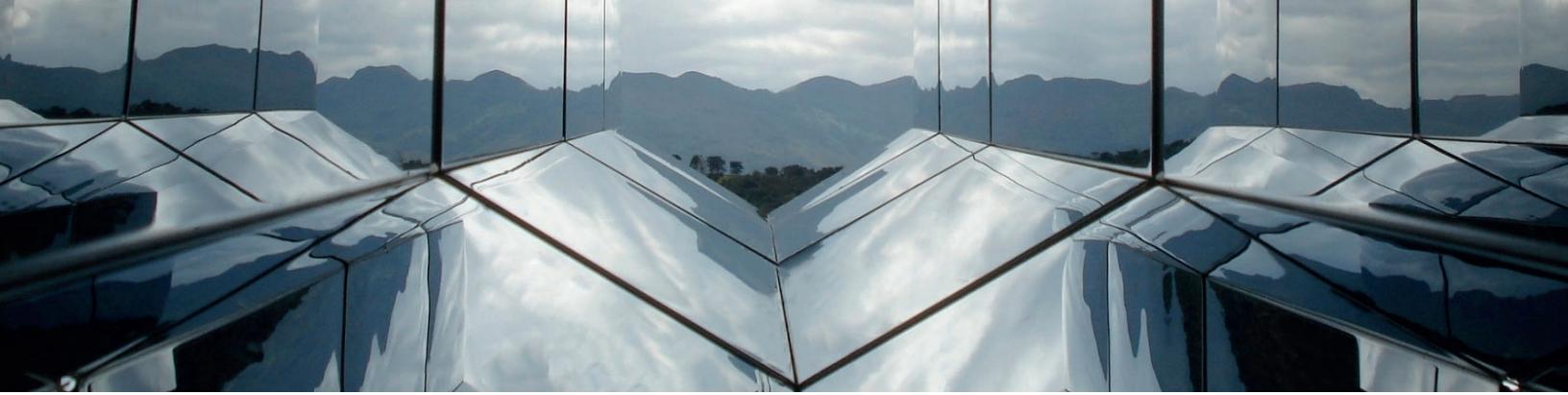


Payments in Canada

A 2020 Update



The way Canadians pay for goods and services continues to evolve from cash and cheques towards new technology and digital payments.

Payments Canada is responding to these changes by carrying out a multi-year initiative to modernize Canada's payment systems and the rules that apply to payment processors and financial institutions. Payments Canada has identified eight needs for Canada's payments infrastructure:



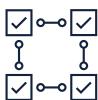
1. faster payment options;



2. data-rich payments;



3. transaction transparency;



4. easier payments;



5. cross-border convenience;



6. activity-based oversight;



7. open & risk-based access; and



8. a platform for innovation.

Payments Canada says its modernization effort will improve the way payments are made and processed for all stakeholders. For financial institutions, enhancing the payments system will support product and service innovations. For other payment service providers, the proposed expansion of Payments Canada's membership and the improved functionality of Canada's Real-Time Rail will be vital in realizing the competitive benefits that modernization can provide. For businesses, the introduction of faster, safer and data-rich payments will support increased digitization of payment processes and should encourage innovation to lower operational costs and boost bottom-line returns over time. For consumers, it will introduce new and enhanced payment products for how, where and when consumers can pay.

Payments Canada

Payments Canada is the organization that owns and operates Canada's payment clearing and settlement infrastructure, including associate systems, bylaws, rules, and standards. The organization has approximately 111 member financial institutions that participate in one or more of its financial payment systems. Two of the most significant systems operated by Payments Canada are the Automated Clearing Settlement System ("ACSS"), also known as the retail system, and the Large Value Transfer System ("LVTS").

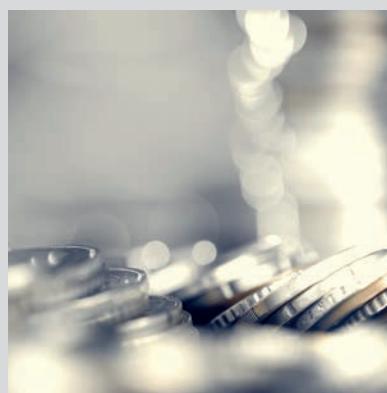
Through the ACSS, the vast majority of both paper-based and electronic payments in Canada are cleared. Specific participant financial institutions who are members of Payments Canada participate directly in the ACSS by handling the clearing and settlement of payments for their own customers, as well as for customers that maintain accounts at the other financial institutions. Direct clearers must maintain settlement accounts at the Bank of Canada. Settlement of the previous day's net balances occurs during the morning of each business day, when settlement account balances are extinguished via payments to and from the Bank of Canada.

The LVTS is an electronic wire system that facilitates the irrevocable transfer of payments between Canadian financial institutions. Members connect to this system via a secure network owned and operated by Payments Canada. While actual settlement with the Bank of Canada occurs at the end of each day, the funds are credited to the recipient's account in near real-time.

Payment Canada's Modernization Project

Payment Canada's Modernization Project is made up of three key initiatives which will be rolled out within the next few years:

1. **Lynx** – a new high-value payments system that will replace the current LVTS.
2. **Real-Time Rail** – a new real-time payments system that will provide 24/7/365 payments that are final and irrevocable.
3. **Retail Batch Payments** – a new enhanced centralized retail batch payments system.





Lynx high value payments system

As the new high-value transfer system that will replace the LVTS, Lynx will facilitate the secure transfer of irrevocable payments made between member financial institutions. The system will be a Real-Time Gross Settlement System (“**RTGS**”) with an enhanced risk model that complies with Canadian and international risk standards. The ultimate goal for Lynx is to have a safe and secure foundation for payments between institutions that supports a dynamic pay environment. It is expected that Lynx will go live in 2021.

In Payments Canada’s Consultation on the Lynx Policy Framework (the “**Lynx Consultation**”) released in September 2019, the organization provided an overview of the key policies that would underpin Lynx including access to the system, finality of payments and deductions of service charges.

The biggest change proposed by Payments Canada in the Lynx Consultation is that participation in the new high-value transfer system will be opened up to entities affiliated with Payments Canada members. Affiliates, like member participants, will be treated as separate entities, and will have to complete application procedures, establish and maintain a settlement account at the Bank of Canada, and meet other requirements set out in the rules, by-laws, and service level description. Affiliate participation is restricted in the current LVTS because of the greater risk exposure these affiliates pose for the Bank of Canada and other participants. However, the RTGS model ensures credit risk exposure is fully covered by its participants. The enhanced safety with Lynx will therefore enable more access to direct participation and foster competition.

For other aspects of the system, Payments Canada proposed that many of the current policies in effect under the LVTS be transferred over to Lynx. Regarding the finality of payments, participants who receive funds will still be required to make the amount of the payment fully and irrevocably available to the payee either at the end of a cycle or upon reasonable request by the payee for the amount, and the handling of misdirected funds will still depend on the terms of participant-customer agreements. For deductions of service charges, Payments Canada will continue to encourage voluntary adoption of practices to credit the payee with the full amount sent by the originator and to invoice wire charges separately.

Lynx next steps

Payments Canada ended consultation on its Lynx Proposal on November 15, 2019. The next step for Lynx is its release, which will occur in two phases. Release one will consist of the RTGS, while release two will deliver end-to-end user support for ISO 20022 messaging. If Payments Canada is able to achieve its 2020 milestones of completing the Lynx solution infrastructure build and commencing industry testing, Lynx should go live in 2021.

The Real-Time Rail payments system

Canada's new real-time payments system Real-Time Rail ("RTR") will provide 24/7/365 payments that are final and irrevocable. Currently, Canada has a near real-time money transfer service for individuals and small businesses, which is offered by most financial institutions in Canada. Under the current system payments are typically received within 30 minutes. With the new RTR system, payments will be able to occur instantaneously and will be secure and irrevocable, ensuring they are final. Canada's RTR is expected to go live in 2022.

On its RTR Fact Sheet, Payments Canada lists scenarios, such as the following, in which the RTR will assist government, businesses and individuals with payments in the future:

- Governments – Payments Canada provides the example where there is an emergency in the province and a government organization has to distribute emergency funds. With real-time payments, those funds can be sent instantly and securely to a business or individual's account together with important embedded information, like what the payment is for, travelling alongside the payment.
- Businesses – Payments Canada envisions the benefits both employees and employers will receive by using real-time payments. Hourly workers, for example, will be able to be paid for the time they have worked immediately after a shift. Business owners will be able to make use of a new Request to Pay feature, built into the RTR, to send an electronic request for a payment to a customer which will show the amount, due date and potentially other payment instructions, simplifying the follow-up process.
- Individuals – Payments Canada suggests that activities like paying rent and making a down payment on a first home will all be possible with real-time payments, eliminating the need for cheques and bank drafts.

Payments Canada also views the new system as an opportunity for players in the payments ecosystem to innovate. These players, including financial institutions and payment service providers, will be able to leverage the RTR to deliver faster, data-

rich payments and new services to business and individuals. They will also be able to provide competitive services supported by the RTR, such as services that improve the customer experience with bill payments, social media payments or QR code payments.

RTR next steps

Payments Canada intends to launch the RTR as a single release that will follow the launch of Lynx sometime in 2022. At launch, the RTR will incorporate number-based routing and the ISO 20022 message standard.

WHAT IS ISO 20022?

ISO 20022 is a global standard for exchanging electronic messages between financial institutions. By adopting ISO 20022, the Canadian payments system benefits from:

- Enhanced remittance data: This means more information — such as information from multiple invoices — can be sent with a single electronic payment, reducing the need for manual intervention;
- Support for global interoperability: Canada is joining numerous countries around the world in adopting ISO 20022 to facilitate cross-border payments, which will also support global competitiveness for Canadian businesses;
- Efficiencies in managing/supporting multiple payment standards;
- Reduction in the use of paper-based options: ISO 20022 will provide Canadians with attractive electronic payment options that reduce costs and inefficiencies over paper-based alternatives.



Conclusion

The way Canadians make payments today is much different than it was in decades past. Tapping a debit card or a phone at a point of sale terminal, and paying directly from a mobile wallet, are just a couple of the common modern ways in which Canadians pay for their everyday items. The desire for better contactless payment options will likely only increase as a result of the COVID-19 pandemic.

Soon, the final and instantaneous ways of making payments that consumers have been able to take advantage of for years will be available for businesses making large transactions, and for the institutions who process these payments. The players within the

Canadian payments ecosystem responsible for moving the money involved in the millions of transactions made every day will soon be able to do this work faster, safer, and more efficiently than ever before.

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