

Written Submission for the Retail Payments Supervision Consultation

Submitted by: Canadian Web3 Council

May 21, 2024

Summary

The Canadian Web3 Council appreciates the opportunity to support the Bank of Canada's ongoing efforts to protect consumers and maintain trust in the reliability and security of Canada's payment systems. In sharing our members' operational expertise, we hope to inform the Guidelines surrounding the *Retail Payments Activities Act* ("the RPAA") for payment systems built on blockchain infrastructure.

To ensure our members can continue to build and deploy globally competitive innovations while preserving consumer trust, we have outlined several provisions of the guidelines which require clarification for payment service providers (PSPs) and their end-users who use or accept fiat-backed stablecoins as a means of payment. We believe that end-user funds should be protected at all times during the entire payment cycle, regardless of the means of payment, and hope that our insights will help inform the final guidelines accordingly.

Our submission focuses solely on the use of fiat-backed stablecoins as a means of payment. Since end-users who accept fiat-backed stablecoins expect regulated PSPs to provide the same protections as for those accepting only fiat currencies, we believe greater attention to this market segment is warranted. Indeed, as PSPs provide merchants with an increasing variety of seamless payment options at checkout (e.g., as with Stripe¹ announcing plans to accept USDC), it is essential for ecosystem participants to have clarity on their obligations to conduct their operations. We also reiterate that fiat-backed stablecoins are digital payment tokens—not securities, commodities, or network assets.

Further, we note that PSPs perform the same payment functions regardless of the means of payment, whether using fiat currencies or fiat-backed stablecoins. PSPs can certainly facilitate transactions using fiat-backed stablecoins as part of the payment process. Yet, absent further clarifications, we have concerns that end-users who accept fiat-backed stablecoins as a means of payment at checkout will not have the same protections as those who accept only fiat currency. Consequently, we believe there are gaps in the current framework, as we expand upon in Appendix A.

More importantly, some PSPs that accept or provide alternative payment methods may have voluntarily implemented safeguarding and risk mitigation measures to protect consumers. Consequently, we believe that a gap in the framework may not translate to actual risk for merchants. In such cases, we seek to dispel any false narrative that it is riskier for merchants to accept fiat-backed stablecoins for payments. We therefore highlight certain measures taken by PSPs to address the principal risks that the Bank of Canada seeks to address through the RPAA and its related guidelines, as articulated in our recommendations below.

¹ Stripe also provides content creators an option to receive USDC payouts (the program is in Beta. Stripe will convert fiat payments to USDC for content creators who elect USDC payouts.)

Finally, to achieve the consumer protection and financial stability goals proportional to the residual risks of using fiat-backed stablecoins, we reiterate a need to bring non-bank issuers of fiat-backed stablecoins under federal jurisdiction. Indeed, as payment instruments and per the nature of the Canadian financial system, this is the purview under which they belong - not under that of the Canadian Securities Administrators. Using a prudential framework that recognizes the quality of the reserve assets that fully back their issuance will provide supervisors with the necessary tools to intervene when necessary. This recommendation, if adopted, would provide a robust framework for regulating fiat-backed stablecoin arrangements and promote trust in such payment systems.

We seek clarification that the following payment functions using fiat-backed stablecoins are captured under the RPAA. This clarity is needed as the Bank of Canada has not yet prescribed fiat-backed stablecoins as a means of payment under the RPAA. For any functions that are not covered by the *RPAA* framework, we believe regulated PSPs should disclose to end-users any residual risks of accepting fiat-backed stablecoins.

Clarification #1:

Context: It has been made clear that the RPAA does not currently cover crypto activities. We are seeking clarification that the concept of a payment function under the RPAA includes the use of fiat-backed stablecoins, which would bring their use under the purview of the RPAA to be regulated as payment activities.

We seek clarification that the conversion of fiat-backed stablecoins (i.e., a digital payment instrument) to fiat currency (and vice versa) is a payment function as opposed to a trading function.

This clarification serves two important goals by:

- Bringing such payment activities under the oversight of the Bank of Canada rather than dividing the regulatory oversight across multiple agencies.
- Addressing the requirement under the *RPAA Guideline Safeguarding end-user funds (Safeguarding Account paragraph 2.4)* for PSPs to not commingle accounts (e.g. accounts used for trading vs payments). This clarification allows PSPs to simplify and streamline operations (i.e., PSPs can use the same digital wallet for fiat on/off ramp transactions for safekeeping end-user funds). This measure will also provide a smoother transition for innovators once certain payment systems built on blockchain rails become prominent payment systems.

Until the Bank of Canada prescribes fiat-backed stablecoins to be a payment instrument under the definition of a “retail payment activity” under the *RPAA*, the clarification that “conversion of

fiat-backed stablecoins to fiat and vice versa” is a payment function will provide needed clarity to PSPs and their end-users.

Clarification # 2:

Context: The RPAA defines various "Payment Functions," such as maintaining accounts, holding funds, initiating electronic funds transfers (EFTs), and providing clearing or settlement services. We seek clarification that these functions also apply to fiat-backed stablecoins when used as a means of payment.

We seek clarification on the following subparagraphs of the *RPAA* definition of a “Payment Function” when accepting fiat-backed stablecoins as a means of payment, as expanded upon in Appendix B:

- Subparagraph (a): using a PSP administered digital wallet² to accept payments of fiat-backed stablecoins is the equivalent of providing or maintaining an account for the Electronic Funds Transfer³ on behalf of end-users. This would serve to meet the consumer protection goals for end-users.
- Subparagraph (c): placing an on-chain transaction and converting from fiat-backed stablecoins to fiat and vice versa is equivalent to “initiating an EFT at the request of the end-user”. This also includes services offered by PSPs to convert fiat-backed stablecoins to fiat currency⁴ for merchants (whether as a standing instruction or on an as requested basis).

These payment functions are performed by the PSP (and more importantly the “funds” are “held” by the PSP) before the fiat funds are sent to the merchants’ bank account. This would serve two important consumer protection measures for end-users:

- Addressing end-user expectations that their funds are protected by PSPs in accordance with the guidelines. Put differently, this measure would alleviate any confusion over what types of payment activities are, or are not, regulated by the RPAA once the amendments take effect.
- Ensuring that end-users receive the same protections for their funds at all times, regardless of the means of payment.

We believe that these clarifications will inform the technical business requirements when building for alternative payment methods.

² In the digital payments ecosystem, view digital wallets as the equivalent to a merchant account in the fiat world of retail payments

³ **Electronic funds transfer** means a placement, transfer or withdrawal of funds by electronic means that is initiated by or on behalf of an individual or entity. **This broad definition captures processing transfers of value on-chain**

⁴ These measures are needed given that settlement periods can vary, i.e. some PSPs offer daily settlements while others offer periodic settlements.

Clarification #3

Context: The RPAA defines "Payment Function" to include holding funds on behalf of end-users until they are withdrawn or transferred. We are making analogies to fiat-backed stablecoins.

We seek clarification on the following with respect to subsection (b) in the definition of a payment function:

- Whether the term "funds" includes a digital representation of value in the form of a fiat-backed stablecoin token.
- Whether holding funds on behalf of the end-user until withdrawn or transferred to another entity or individual includes the reserve assets held by the issuer of the fiat-backed stablecoins.

These clarifications will bring such assets under the *Guidelines Safeguarding end-user funds*.

Clarification #4

Context: With reference to section 12 of the *Guidelines Operational risk and incident response*, we seek clarification that the RPAA extends to third-party payment applications built on decentralized blockchain networks but not the blockchain networks themselves.

We view decentralized Layer 1 blockchain networks (e.g., the Ethereum base layer) as public utilities similar to the internet. As such, we seek clarification that Layer 1 decentralized blockchains do not fall under the *RPAA* as their fundamental decentralized nature and open-access characteristics make them akin to foundational infrastructure rather than financial service providers.

We believe further discussions are warranted for third party payment applications (including those functions performed by fiat-backed stablecoin operators) that are built on top of the Layer 1 blockchains, i.e., to determine whether and how the third-party service provider requirements under the *Retail Payment Activities Regulations "RPAR"* section 5(3) *Third Party Service Providers* apply.

Recommendation to recognize alternative payment methods

We stress the importance of using a consistent framework to regulate alternative payment systems as the current *RPAA* framework does not specifically include innovative payment systems built on blockchain rails. Including these payment systems is needed to address the variety of payment options that are now offered at checkout on e-commerce platforms.

We reiterate the need to bring issuers of fiat-backed stablecoins under federal jurisdiction. We also encourage Finance Canada and the Bank of Canada to work with OSFI and the Canadian securities regulatory authorities to harmonize rules around the issuance and distribution of fiat-referenced stablecoins, in particular around consumer protections. Given the unique properties of fiat-backed stablecoins, we believe that the regulation of such arrangements will require a blend of both payment system oversight, prudential considerations, and that provides supervisors with the necessary tools to monitor and address any financial stability concerns should fiat-backed stablecoins become widely adopted.

Ideally, Ottawa would create a distinct framework to regulate fiat-backed stablecoin arrangements. Such a framework should maintain the RPAA's focus on operational resilience, consumer protection, transparency, and innovation. If placed under the purview of experienced supervisors with expertise in preserving financial stability, the regime would empower innovators to deploy new products and services while assuring consumers of these new offerings' safety.

Practically, it may be more feasible in the interim to regulate fiat-backed stablecoin arrangements as payment instruments using existing regulatory frameworks. However, this approach will require careful consideration, coordination and collaboration amongst stakeholders to calibrate the regulations and allocate responsibilities to provide effective coverage, and without duplication and stifling innovation.

Ultimately, we hope the Bank of Canada will use its authority under the RPAA to prescribe the criteria to bring fiat-backed stablecoins under the RPAA as an alternative payment method, as this would provide consumers with faster and cost effective payment methods, and which would also allow innovation to occur within a regulated framework.

The below examples show how some industry participants may already meet the specific requirements set out in the Guidelines, and we encourage the Bank of Canada to work with industry to incorporate these and other measures in future Guidelines.

Alternative approaches to safeguarding end-user funds

Paragraph 20(1) of the *RPAA* lists the different ways a PSP can safeguard end-user funds. Paragraph 2.3 of the Guidelines states that “Paragraph 20(1)(b) of the *RPAA* provides the authority for regulations to prescribe alternative approaches to safeguard end-user funds”, however, the *RPAA* does not currently include any alternatives.

Some fiat-backed stablecoin issuers hold secure and liquid⁵ reserve assets backing the fiat-backed stablecoins at 100% for the benefit of end-users, which achieves the same goals as

⁵ See paragraphs 3.20 and 3.21 of the *Guideline Safeguarding end-user funds* for a discussion of what assets are or are not considered secure and liquid reserve assets.

contemplated under *Safeguarding Account*. We ask the Bank of Canada to recognize a fiat-backed stablecoin issuer that holds 100% reserve assets for fiat-backed stablecoins for the benefit of end-users as a prescribed method of safeguarding end-user funds. We also recommend that the Guidelines prescribe a requirement for issuers of fiat-backed stablecoins to adopt the following measures:

- Place the reserve assets with a regulated digital asset custodian that is subject to prudential requirements.
- Provide periodic independent attestations of the reserve assets (e.g. monthly) by a public accountant.
- Publicly disclose the holdings of assets in reserve along with the independent accountants' report.

Alternative approaches to providing safeguarding accounts

Paragraphs 2.13 and 2.14 of the Guidelines require a safeguarding account be provided by an entity described in section 13 of the *RPAR*. The *RPAR* currently contemplates only a prudentially regulated Canadian financial institution, or “a foreign financial institution that is regulated by a regulatory regime that imposes standards in respect of capital, liquidity, governance, supervision and risk management that are comparable to those that apply to those entities, to be account providers” (an “acceptable party”).

End-users who accept fiat-backed stablecoins as a means of payment will use either a PSP administered wallet with a Canadian regulated crypto trading platform (“CTP”), or hold the fiat-backed stablecoins directly in a self-hosted wallet. We ask the Bank of Canada to consider a Canadian regulated CTP that is regulated by (or seeking registration with) Canadian Investment Regulatory Organization (“CIRO”) as an acceptable party to providing a safeguarding account.

The above are only a few examples of additional measures that achieve consumer protection outcomes. We hope that the Bank of Canada is open to hearing what additional measures or tailoring of the Guidelines may be needed to bring fiat-backed stablecoin arrangements under federal jurisdiction, including the use of regulatory sandboxes to provide a controlled environment for issuers to test and refine their compliance measures before full implementation.

Conclusion

Ultimately, we believe that using a clear and consistent payments framework to regulate fiat-backed stablecoins as payment instruments will enhance end-user protection and align Canada with global regulatory frameworks. Paving this path will promote domestic competition, allow Canadian companies to expand their global footprint, support responsible innovation, and encourage the adoption of new payments technology that yields efficiencies and increases productivity. This reflects our belief that regulating such participants is essential in order to establish trust and to promote the safety and reliability of new payment systems.

As regulators are essential actors in the financial services ecosystem, we hope continued dialogue between industry participants and supervisors will encourage safe and secure financial services offerings as payment systems built on blockchain rails become more prominent. Accordingly, we invite the Bank of Canada to collaborate with industry participants to implement the sensible regulations that would bring fiat-backed stablecoins under a payments regulatory framework.

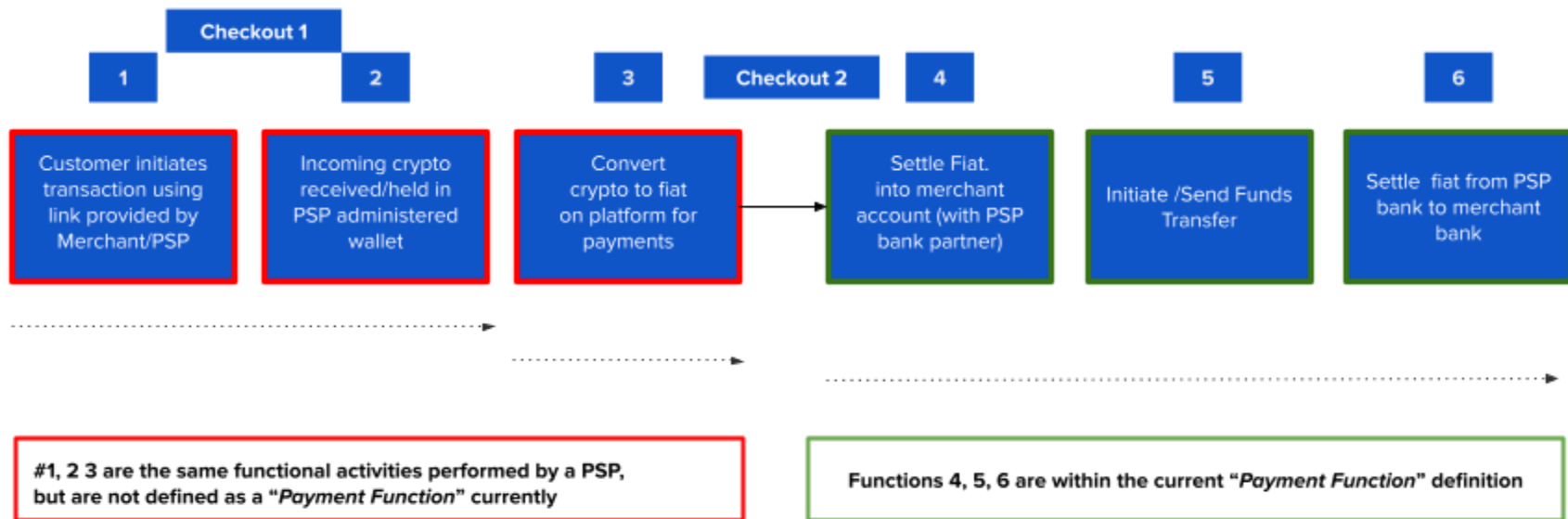
About the Canadian Web3 Council (CW3)

The CW3 is a non-profit trade association founded by industry leaders to work constructively with policymakers and to establish Canada as a leader in Web3 technology. The CW3 represents organizations that have made a critical impact on the development of Web3 technologies across the globe, and who are committed to responsibly building and innovating in Canada. Our members have operations in Canada and abroad, and this diverse group ranges from providers of centralized and decentralized financial products and digital trading platforms, to digital asset custodians, liquidity providers, investors, and open-source blockchain projects. Our members operate in over 100 countries and are committed to the responsible development of the Web3 digital asset ecosystem.

Appendix A

The below activities are performed by PSPs for merchants who accept crypto assets as a means of payment, and who elect to receive payments in fiat currency (i.e., requires the PSP to convert the fiat-backed stablecoins to fiat currency). This example assumes the PSP bank is different from a merchant bank.

To perform all 6 payment functions, a regulated PSP requires access to blockchain/fiat payment rails (directly or through a partner such as a bank, FBSC issuer, CTP etc.)



#1, 2 3 are the same functional activities performed by a PSP, but are not defined as a "Payment Function" currently

Functions 4, 5, 6 are within the current "Payment Function" definition

---> Completion time will depend on payment rail settlement times (including interoperability of fiat/blockchain rails), and access to services (e.g. over a weekend)

Checkout Option 1 = end-user decides to hold crypto assets in a PSP administered wallet
 Checkout Option 2 = end-user asks the PSP to convert crypto to fiat

Appendix B

This table applies the current definition of a payment function to the use of fiat-backed stablecoins

Current definitions under <i>RPAA</i>	Applying the <i>RPAA</i> definitions to the use of fiat-backed stablecoins in retail payments
<p><i>RPAA</i> definition of a “Payment Function” includes any of the following</p> <ul style="list-style-type: none"> a. Provide/ maintain an account for the electronic funds transfer) on behalf of the end-user b. Hold funds on behalf of the end-user until withdrawn or transferred to another entity or individual. c. Initiate an EFT at the request of end-user d. Authorize EFT/transmission, reception, facilitation of an instruction re the EFT e. Providing clearing/settlement service 	<p><i>Terminology that is often used for digital assets/new payment systems</i></p> <ul style="list-style-type: none"> a. Provide/maintain a <u>PSP hosted digital wallet</u> for the EFT on behalf of end-users b. Funds include a <u>digital representation of value</u> (e.g. in the form of a fiat-backed stablecoin token), and the reserve assets c. Initiate an EFT includes <u>placing an on-chain transaction and converting from crypto to fiat and vice versa</u> d. Clarify the equivalent functions in the context of on-chain transactions (instruction = data) e. Providing clearing/settlement <u>includes a recordkeeping function</u>, e.g. by maintaining a separate ledger when using omnibus wallets held for the benefit of customers
<p>An electronic funds transfer means a placement, transfer or withdrawal of funds by electronic means that is initiated by or on behalf of an individual or entity</p>	<p>“EFT”, Electronic Funds Transfer includes instructions to convert from a prescribed digital asset to fiat and vice versa. This will provide interim clarity that the activity will be subject to a consistent set of regulations</p>