



# Regulatory Oversight of Designated Clearing and Settlement Systems

This section describes **what a financial market infrastructure (FMI)** is and the FMIs designated as **systemically important** or as **prominent payment systems** to Canada's financial system, as well as the Bank's oversight responsibilities under the *Payment Clearing and Settlement Act*.

## Explaining financial market infrastructure

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A financial market infrastructure (FMI) is a system that facilitates the clearing, settling or recording of payments, securities, derivatives or other financial transactions among participating entities. It's also called a "clearing and settlement system." FMIs play an important role in enhancing financial stability by enabling consumers and firms to safely and efficiently purchase goods and services, make financial investments, and transfer funds.

Under the *Payment Clearing and Settlement Act*, the Bank is responsible for the oversight of FMIs that have the potential to pose systemic or payments system risk. These include three types of designated FMIs:

1. payments systems (PSs) – which facilitate the transfer of funds;
2. central counterparties (CCPs) – which become the buyer to every seller and the seller to every buyer of a financial contract to ensure that, even if a buyer or a seller fails to meet its obligation to the CCP, obligations will be met on all contracts; and
3. securities settlement systems (SSSs) – which facilitate the transfer of securities and other financial assets. These systems often operate in conjunction with central securities depositories (CSDs), which provide securities accounts, central safekeeping and asset services. Securities settlement systems may provide additional securities clearing and settlement services, such as CCP clearing services.

## Systemically important FMIs

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Some FMIs have the potential to pose systemic risk to Canada's financial system, in that the inability of one participant to meet its obligations to the FMI could, by transmitting financial problems through the FMI, cause other participants to be unable to meet their obligations. It is therefore essential that FMIs incorporate appropriate risk-control mechanisms so that systemic risk is adequately controlled. The objectives of the Bank in its oversight role are to ensure that systemically important FMIs operate in such a manner that risk is properly controlled and to promote efficiency and stability in the Canadian financial system.

The Governor of the Bank of Canada has designated the following FMIs as systemically important to Canada's financial system and subject to the Bank's oversight:

- **Lynx**, a Canadian electronic funds-transfer system that settles large-value and time-critical Canadian-dollar payments;
- **CDSX**, a Canadian system that consists of a central securities depository and a securities settlement system for eligible exchange-traded and over-the-counter equity, debt and money market transactions, as well as a central counterparty service for eligible exchange-traded and over-the-counter equity transactions;
- **Canadian Derivatives Clearing Service (CDCS)**, a Canadian central counterparty that clears transactions in certain fixed-income securities, repurchase agreements (repos), equity derivatives, and all derivatives traded on the Montréal Exchange;
- **CLS Bank**, a global payment system for the settlement of foreign exchange transactions, including those involving the Canadian dollar; and
- **SwapClear**, a global system for the central clearing of interest rate swaps and other over-the-counter interest rate derivatives denominated in multiple currencies, including the Canadian dollar.

## Prominent payment systems

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In December 2014, the Bank's oversight responsibilities were expanded to include prominent payment systems. These payment systems, while not systemically important, are critical for economic activity in Canada. Disruptions or failures could have the potential to pose risks to Canadian economic activity and affect general confidence in the payments system.

The Governor of the Bank of Canada has designated the following FMIs as prominent payment systems and are subject to the Bank's oversight:

- the Automated Clearing Settlement System (ACSS), a Canadian deferred net settlement system that clears retail payments;
- **Interac e-Transfer<sup>®</sup>**, a Canadian electronic funds transfer system between personal and business accounts.

Like systemically important systems, it is important that these systems have appropriate risk controls in place to control "payments system risk".<sup>1</sup> However, the nature and magnitude of the risks faced will be different than those that are relevant for systemically important systems, and therefore the risk controls may also differ in some areas.

The Bank has developed risk-management standards which will be applied to these systems.

## Consultations on the Criteria and Risk-Management Standards for Prominent Payment Systems: Summary and Responses to Comments Received

### Criteria and Risk-Management Standards for Prominent Payment Systems

## The Bank's responsibilities under the Payment Clearing and Settlement Act

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Since 1996, Canada's *Payment Clearing and Settlement Act (PCSA)* has conferred on the Bank of Canada specific responsibilities and powers for the oversight of FMIs. The Act recognizes the essential role of the major clearing and settlement systems (also known as FMIs) in the Canadian economy, and of the importance of regulatory oversight of them.

## Oversight responsibilities for clearing and settlement systems

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The PCSA provides the Bank with two main oversight responsibilities:

- designating clearing and settlement systems, also known as FMIs, that have the potential to pose systemic or payments system risk
- overseeing designated FMIs to ensure that they are adequately controlling systemic or payments system risk

## Supporting powers

The PCSA also:

- allows the Bank to collect information from FMIs to determine their eligibility for oversight and to determine whether they have the potential to pose systemic or payments system risk, as defined in the PCSA
- empowers the Governor of the Bank to designate an eligible FMI as being subject to Bank oversight when he is of the opinion that the FMI may be operated in such a manner as to pose systemic or payments system risk, and the Minister of Finance is of the opinion that it is in the public interest to designate it
- empowers the Bank to issue guidelines relating to its administration of the Act
- allows the Bank to enter into an agreement with a designated FMI with respect to its oversight arrangements or other matters that pertain to the FMI's control of systemic or payments system risk
- empowers the Bank to conduct audits of a designated FMI
- requires designated FMIs to provide the Bank with such information as it may require
- requires that all information obtained by the Bank from an FMI under the PCSA be treated as confidential, while still allowing the Bank to share such information with the FMI's other regulatory authorities, as it relates to the regulatory activities of those institutions in relation to the FMI

- empowers the Governor to issue a written directive to a designated FMI to refrain from an action that is likely to result in systemic or payments system risk being inadequately controlled or to take action to remedy a situation in which systemic or payments system risk is likely being inadequately controlled
- empowers the Governor to apply to a superior court to obtain an order directing an FMI to comply with the PCSA, a directive or a legal agreement entered into with the Bank under the PCSA
- empowers the Governor to issue a written directive to a participant to take corrective measures under specific circumstances
- requires designated FMIs to provide the Bank with reasonable notice in advance of any change to be made that is of a significant nature in relation to the designated FMI, which enables the Bank to consider the implications of such changes for systemic or payments system risk
- empowers the Governor to restrict and place conditions on the participation of foreign institutions in designated systems
- empowers the Bank to provide a guarantee of settlement to designated FMIs
- empowers the Bank to make liquidity loans to designated FMIs
- empowers the Bank to accept and pay interest on deposits from the FMIs and their participants

## **Additional legal protections**

The PCSA also contains provisions that provide certain legal protections for designated FMIs. These provisions:

- in conjunction with federal insolvency legislation, bolster the legal enforceability of netting in designated FMIs
- render the settlement rules of designated FMIs immune to stays or other legal challenges, even in cases where a participant in one of these systems fails (this increases the certainty that the legal arrangements governing the operations of a designated clearing and settlement system will produce the expected outcome in periods of financial stress)
- protect the settlement of clearing systems on the books of the Bank from stays and unwinds
- protect against stays the exercise of rights in the collateral that secures obligations in the system

## **Cooperative Oversight**

The Bank works cooperatively with various authorities who also have responsibility with respect to systems overseen by the Bank.

The Autorité des marchés financiers (AMF), the British Columbia Securities Commission (BCSC), and the Ontario Securities Commission (OSC) have regulatory responsibility for the Canadian Depository for Securities (operator of CDSX) and the Canadian Derivatives Clearing Corporation (operator of CDCS). As a result, the Bank and these authorities have overlapping responsibilities. The Bank of Canada has entered into a **Memorandum of Understanding (MOU)** with these authorities to facilitate co-operation in carrying out their respective oversight responsibilities for CDSX and CDCS. The MOU establishes a common framework for information sharing, consultation and coordination among these authorities. The MOU provides a structure for co-operation among the parties in order to promote the safety and efficiency of these FMIs.

Under the *Canadian Payments Act* (CP Act), the Minister of Finance has the responsibility to oversee Payments Canada, which owns and operates Lynx and ACSS, both of which have been designated by the Bank.

The Bank of Canada and the Department of Finance have established the Payments Advisory Committee (PAC) to coordinate oversight activities related to the broader payments system. The Bank and Finance coordinate responsibilities through a Terms of Reference that establishes a common framework for information sharing, consultation and coordination. The Terms of Reference provides a process for co-operation between the Bank and Finance in order to promote the safety and efficiency of Canada's payments systems.

Two of the systems designated by the Bank, CLS Bank and SwapClear, are owned and operated outside of Canada. As a result, the Bank participates in cooperative oversight arrangements with foreign authorities. Cooperative oversight allows for more efficient oversight where there are multiple oversight authorities. However, the Bank maintains all its responsibilities or powers with respect to the overseen FMI.

For CLS, the Bank participates in a cooperative oversight arrangement, led by the **Federal Reserve**, with participation from central banks whose currencies are settled in CLS.

For SwapClear, the Bank participates in a multilateral arrangement for oversight co-operation led by SwapClear's lead regulator, the Bank of England.

## Related

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### **Release of the 2020 Bank of Canada FMI Oversight Activities Annual Report**

June 23, 2021

The Bank of Canada today published the *Bank of Canada Oversight Activities for Financial Market Infrastructures 2020 Annual Report*. The Report reviews the Bank's oversight of designated clearing and settlement systems, also known as financial market infrastructures (FMIs).

Content Type(s): **Press**, **Market notices**

## Release of the 2019 Bank of Canada FMI Oversight Activities Annual Report May 15, 2020

The Bank of Canada today published the *Bank of Canada Oversight Activities for Financial Market Infrastructures 2019 Annual Report* (the Report) on its oversight of payment clearing and settlement systems, which are also known as financial market infrastructures (FMIs).

Content Type(s): **Press, Market notices**

## Release of the 2018 Bank of Canada FMI Oversight Activities Annual Report March 27, 2019

The Bank of Canada today published the *Bank of Canada Oversight Activities for Financial Market Infrastructures 2018 Annual Report* (the Report) on its oversight of payment clearing and settlement systems, which are also known as financial market infrastructures (FMIs).

Content Type(s): **Press, Market notices**

## Release of the 2017 Bank of Canada FMI Oversight Activities Annual Report April 9, 2018

The Bank of Canada today published the 2017 annual report on its oversight of payment clearing and settlement systems, which are also known as financial market infrastructures or FMIs.

Content Type(s): **Press, Market notices**

## Release of the 2016 Bank of Canada FMI Oversight Activities Annual Report April 4, 2017

The Bank of Canada today published the 2016 annual report on its oversight of payment clearing and settlement systems, which are also known as financial market infrastructures or FMIs.

Content Type(s): **Press, Market notices**

## Release of the 2015 Bank of Canada FMI Oversight Activities Annual Report May 5, 2016

The Bank of Canada today published the 2015 annual report on its oversight of payment, clearing and settlement systems, which are also known as financial market infrastructures or FMIs.

Content Type(s): **Press, Market notices**

### Footnotes

1. The *Payment Clearing and Settlement Act* defines payments system risk as the risk that "a disruption to or a failure of a clearing and settlement system could cause a significant adverse effect on economic activity in Canada by (a) impairing the ability of individuals, businesses or government entities to make payments, or (b) producing a general loss of confidence in the overall Canadian payments system, which includes payment instruments, infrastructure, organizations, market arrangements and legal frameworks that allow for the transfer of monetary value."[\[←\]](#)