

MODERNIZING THE PRE-AUTHORIZED DEBIT FRAMEWORK: PAYMENTS CANADA PROPOSES WELCOME CHANGES

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On November 17, 2021, Payments Canada released a consultation paper, outlining proposed changes to Rule H1 and the Pre-Authorized Debit (“**PAD**”) framework.^[1] Rule H1 governs the procedures for every PAD payment.^[2]

Given that the last framework review of Rule H1 took place in 2008, Payments Canada’s proposed changes are designed to ensure the PAD framework remains relevant given new services, new technologies and the evolving needs of payees and payors. The proposed changes are listed and discussed below:

1. clarify the definition of “Commercially Reasonable”;
2. remove the distinction between Paper and Electronic Agreements;
3. automatically terminate the Payor PAD Agreement when the associated goods and services contract is cancelled;
4. define “One-Time” PADs and prohibit additional transactions under one-time agreements;
5. clarify information requirements when outsourcing PAD processing to Payment Service Providers;
6. modify Rule H1 Appendix II to address the jurisdiction of Payor PAD Agreements and Funds Transfer PADs from a joint bank account;
7. add requirements for Payee-initiated cancellation of a PAD Agreement; and
8. allow Recorded submission of Business PAD reimbursement claims.

1. Clarify the definition of “Commercially Reasonable”

Rule H1 requires all PAD Agreements to be authorized using “Commercially Reasonable” methods. This refers to the security procedures undertaken to verify a person’s identity. Currently, Rule H1 includes a list of considerations that may be used to evaluate the reasonableness of a verification procedure at issue and also includes a non-exhaustive list of examples of commercially reasonable methods. However, these methods may be unnecessarily onerous in certain circumstances and confusion has arisen over whether the examples given are the only acceptable methods of verification.

Payments Canada proposes to review the list of considerations and examples contained in Rule H1, and perhaps remove them entirely, in order to promote more flexibility in verification procedures. The examples

would be replaced with clear wording that the Payee is able to use a form of verification that meets the circumstances of the PAD, their operational capabilities and the Payee's relationship with the Payor, so long as that verification method can ultimately be determined by a court of law.

2. Remove the distinction between Paper and Electronic Agreements

Payor PAD Agreements may be either paper-based or electronic, with different notification and waiver requirements depending on the format. For instance, before the first PAD, the Payor must be notified of mandatory information within 10 days for Paper agreements and within 15 days for Electronic agreements. However, with evolution in technologies, the line between paper and electronic agreements has blurred. For example, is a PAD Agreement signed on a tablet in-person an electronic or paper-based agreement? Which requirements apply?

Payments Canada proposes removing this distinction and unifying the notification and waiver requirements. It also proposes removing the current three-day minimum notification period for electronic agreements.

3. Automatically terminate the Payor PAD Agreement when the associated goods and services contract is cancelled

Currently the cancellation provision of Rule H1 only addresses the cancellation of PAD agreements.^[3] It does not address situations where there is an associated goods and services contract. Without this link, a Payor PAD Agreement may not be cancelled even if the associated goods and services contract is.

Payments Canada proposes including a mandatory cancellation term in Payor PAD Agreements in situations where there is a separate goods and services contract.

4. Define "One-Time" PADs and prohibit additional transactions under one-time agreements

After one-time payments are made under one-time PAD Agreements, the agreement often sits in limbo. It remains in effect unless a cancellation request is initiated and therefore risks additional, unapproved PADs.

Payments Canada proposes adding a definition for "One-Time" PADs and including a mandatory term such that One-Time PADS cannot be authorized for any subsequent PAD transaction.

5. Clarify information requirements when outsourcing PAD payments to Payment Service Providers

Businesses are increasingly using Payment Service Providers ("**PSPs**") to process PAD payments. Under the current Rule H1, when a Payor (i.e. a customer) makes a purchase from an Ultimate Beneficiary Payee (i.e. a business) that outsources PAD processing to PSPs, the PSP's name, and not the Ultimate Beneficiary Payee's name, will appear on the Payor's records. This is confusing for many Payors.

Payments Canada proposes a change to ensure that the Ultimate Beneficiary Payee name, rather than the PSP name, will be displayed in the Payor's banking records. In addition, a requirement to provide the Payor with the information of the applicable PSP processing the PAD payments would be added. Finally, Payments Canada proposes updating the Payee Letter of Undertaking with PSPs to clarify what information Payors must provide in Payor PAD Agreements.

6. Modify Rule H1 Appendix II to address Jurisdiction of Payor PAD Agreement and Funds Transfer PADs from a joint bank account

Canadian jurisdictions have varying privacy and consumer protection legislation. The legislation that applies to a PAD Agreement will vary depending on the governing law of the agreement. Currently Rule H1 does not require Payees to indicate the applicable jurisdiction in their Payor PAD Agreement. Payments Canada proposes to include "jurisdiction" on the Supplemental Elements list of Appendix II to make it clear that this is an element that should be considered for inclusion in Payor PAD Agreements.

Another proposed change relates to Funds Transfer PADs from a joint bank account. These payments require the Payor and the Payee to be the same person. Currently Rule H1 does not specify whether, in a Funds Transfer from a joint bank account, authorization from both account holders is required. Payments Canada proposes to update the PAD Agreement templates in Appendix II to include an example authorization statement indicating that authorization from both account holders is not required.

7. Add requirements for Payee-initiated cancellation of a PAD Agreement

Another shortfall of the cancellation provision of Rule H1 is that it only addresses Payor-initiated cancellations. In certain circumstances, a Payee may wish to cancel a PAD Agreement, but not the underlying goods and services contract (for example, when multiple payments have been returned because the Payor has insufficient funds).

Payments Canada proposes including requirements to address Payee-initiated cancellations that mirror the requirements of Payor-initiated cancellations, such as notifying the Payor in writing of the cancellation and effecting the cancellation within 30 days of such notice.

8. Allow Recorded submission of Business PAD reimbursement claims

Three types of PADs can be reimbursed: Personal, Funds Transfer, and Business. Currently, only Personal and Funds Transfer PAD reimbursement claims can be submitted in Recorded format, meaning "any form of representation of information ... in any medium". Business PAD reimbursement claims must be submitted in Written format, which covers "any form of representing or reproducing words in visible forms, and includes an electronic documents ...".

Payments Canada proposes updating Rule H1 to allow Business PAD Reimbursement claims to also be submitted in Recorded format in order to more appropriately align with the methods currently used by businesses to communicate with their financial institutions.

Conclusion

Payments Canada expects the changes to be launched in multiple phases based on implementation complexity, with the first round of changes effective mid-2022. The consultation is open to consumers and consumer groups, financial institutions, businesses and corporates, and third-party providers. Interested parties may provide comments and feedback by January 14, 2022, by emailing consultation@payments.ca. Although general comments are welcome, Payments Canada is particularly interested in understanding how the proposed changes may affect operational processes, costs, protection of data and recourse options and whether there are any reasons why an organization could not display the Ultimate Beneficiary Payee when using a PSP (as described in item 5 above).

The consultation is a welcome initiative for those struggling to match the guidance set out in Rule H1 with their current business practices, and aligns with the goals of Payments Canada to create and maintain a modern payments infrastructure for Canadians.

[1] Payments Canada, A Proposed Revised Framework for Pre-Authorized Debits, [online](#).

[2] Payments Canada, Rule H1 – Pre-Authorized Debits (PADS), [online](#).

[3] Rule H1, *supra* note 2, s. 27.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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