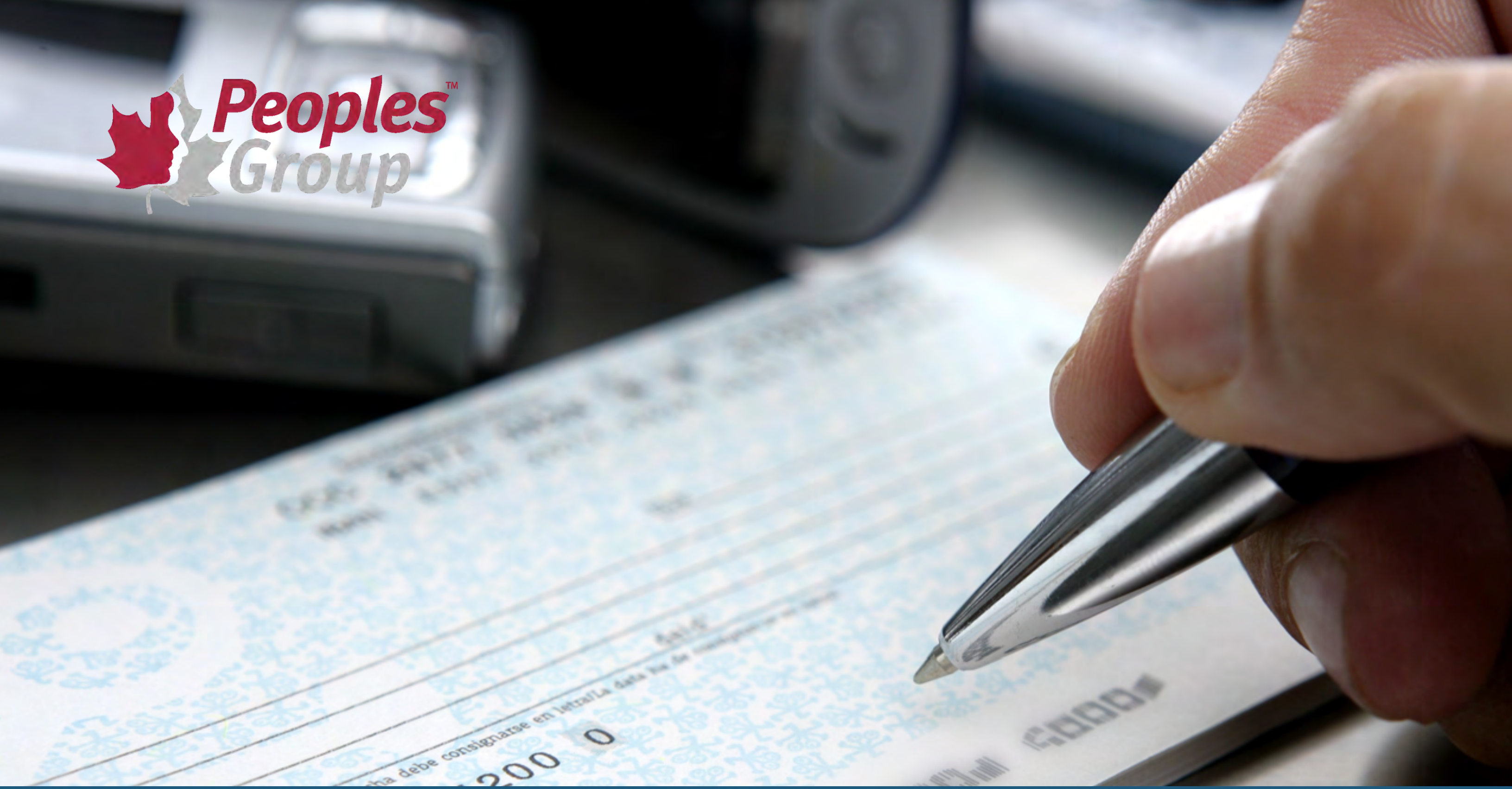

Cheque-ing Out

Prepaid's move to help Canadian businesses break the habit.

PART 2 OF 2

By: Peter Read, Peoples Card Services, President
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Introduction

Canada is the North American front-runner to eliminate cheques, which is one of the many reasons the country is fertile ground for expansion of electronic payments, including prepaid.

All signs point to the nationwide decline in cheque use (at an annual rate of about 7 percent) being good for consumers, businesses and the financial system as a whole. A 2013 report estimated that Canadian businesses could save between CA$1.6 and CA$4.4 billion – each year – by moving to 100 percent electronic payments. Payments Canada forecasts that by 2020, virtually all cheques written by businesses and governments in Canada will have migrated to electronic payments.

7% *the annual rate at which cheque use is declining in Canada*

As we detailed in part one of this two-part series, prepaid is a particularly a well-suited electronic payment method to replace cheques. This is largely due to Canada's stable regulatory environment, and the benefits of prepaid as a payment tool relative to credit and debit products, and most certainly compared to cash.

Prepaid reduces fraud, guarantees funds, eliminates transaction friction, sidesteps debt, and frees buyers and sellers from the restrictions of traditional banking relationships, all without the burden of a traditional bank account.

This flexible payment platform has a wide application for businesses and consumers alike, as we detailed with the benefits of consumer incentive cards, corporate purchasing and payroll cards in part one of this series.

Now, we explore three more corporate-funded market segments that are driving prepaid market growth: insurance, employee and partner incentives and campus applications. And, we'll take a deep dive into navigating the Canadian prepaid regulatory market, with specific insights for program managers looking to expand in Canada.

Canada's Dynamic and Growing Fintech Market

Canadian businesses and consumers wrote almost a billion cheques in 2014. And while that's still far less than the U.S.'s 18.3 billion cheques, Canadian cheque payments did account for a whopping CA$3.9 trillion, or 46 percent of the total transaction value across all the country's payment segments. We expect to see the decline of cheque use continue to accelerate in the coming years as consumers adopt technology and electronic payment solutions.

$3.9 TRILLION
IN CHEQUE PAYMENTS ARE MADE IN CANADA

Canada's business landscape is also changing, driven by the predominance of small and medium enterprises (SMEs), which make up more than half of the nation's GDP, and the growing role of millennials and Gen X in the workforce (combined, they now account for more than 70 percent of working Canadians).

Millennials and Gen X in the workforce combined account for more than 70 percent of working Canadians

As today's business leaders redefine how businesses, governments and consumers pay and get paid, they will chip away at the more than CA$3 trillion in cheques that businesses write annually, and prepaid and other more efficient payment methods will continue to take hold.

At the same time, several Canadian markets, including Vancouver and Toronto, are already recognized as international fintech hubs. These markets are attracting startups like Koho who are activating prepaid in a variety of innovative new ways to deliver electronic payments to consumers and businesses through partnerships with Peoples Trust Company.

Corporate-funded prepaid segments

In part one, we outlined the use cases for consumer incentives, corporate purchasing and payroll card solutions.

Consumer-Funded*	Corporate-Funded*
General purpose reloadable	Campus
In-store gift cards (RAN for retail)	Consumer incentives
Mall gift cards (RAN)	Corporate purchasing
Open-loop gift	Employee benefits
Remittance/P2P	Employee and partner incentives
Single-load general purpose	Insurance claims
Travel cards	Payroll cards

* "Funded" refers to the origination of the funds from a corporation or consumer.
Source: Mercator Advisory Group, 2016

Now we look at three other major categories that are driving prepaid market growth:

1. *Insurance Payments*
2. *Employee & Partner Incentives*
3. *Campus Payments*

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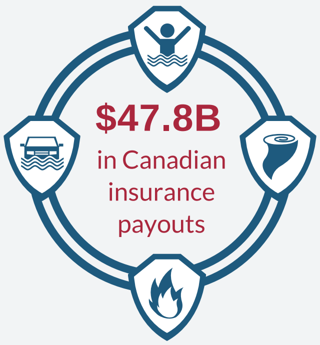
Corporate-funded prepaid segments

Insurance Payments 1

Anyone who's ever waited for their insurance claim reimbursement cheque to come in the mail while their car is not drivable or their home is not livable understands the appeal of immediate access to funds in the form of a prepaid card. Timing is critical – as a majority of Canadians are unprepared to manage any type of shock to their personal finances.



In 2013, the most recent year for industry data, Canadian insurers wrote CA$47.8 billion in direct written premiums for insurance on consumers' homes, cars and businesses, and more than half of every dollar of premiums received by insurers is paid out in claims.

That's a minimum of CA$24 billion, almost all of which has traditionally been paid out by cheque from one of the more than 210 private property and casualty insurers across Canada.

In the U.S., insurance companies are actually heavily invested in the cheque business, some even running their own printing presses – a formidable barrier to any electronic payment solution.

But Canadian insurance companies are beginning to review their entire claims operations process – especially cheque-issuance – to understand how electronic payments can drive operational efficiencies while delivering a better customer experience. The industry's adoption of more mature fintech concepts has been led by payments companies.

Known as "InsurTech," this movement seeks to modernize everything from pricing strategy to customer service and claim processing and payments.

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Aside from eliminating all of the costs and inefficiencies of cheque issuance and cashing, prepaid payment solutions bring big advantages to insurers, in the form of reduced fraud.

By using a RAN (restricted authorization network) , insurance claim payments can be limited to a specific list of approved providers, such as auto body shops and related services, in the case of an auto insurance claim. The RAN concept is a relatively untapped opportunity in the insurance industry – even in the U.S. The insurance provider who takes the lead in this area will have a significant market advantage.

The benefits for consumers are significant as well: prepaid allows insured parties to pay for covered services – such as a dental procedure or a homeowner claim – upfront via prepaid card, rather than paying out of pocket and then managing a slow, cumbersome and time-intensive reimbursement process.

U.S. insurers will do well to take note of how prepaid drives insurtech forward in Canada, so they can export successes back across the border to reduce insurance fraud, increase customer loyalty and provide policy holders with a more secure, widely-accepted form of payment.

Employee & Partner Incentives 2

On the employee front, Benefits Canada recently reported that 60 percent of Canadians are not motivated by their employer's rewards program; and employees prefer prepaid cards 16 times more than receiving company-branded merchandise for a job well done, other recognition or service anniversaries.

Timely awards and the convenience of an immediate payment method (no more cashing or depositing cheques that end up being used to pay utility bills) are a huge draw for card recipients, and open-loop prepaid cards allow employees to apply the funds as they see fit, such as for some guilt-free shopping, rather than being limited to making a purchase using a store gift card at a specific merchant which they may not frequent.

Blackhawk Engagement Solutions' research shows that open-loop prepaid cards are the top reward choice in many common scenarios. For example, if offered a $100 reward, 92 percent of employees would prefer an open-loop prepaid card, versus a reward that can be redeemed online from select retailers (6 percent) or a catalog where rewards can be chosen (2 percent).

Further, their research shows employees prefer prepaid cards even when the value is less than other rewards, for example, 45 percent would prefer a $500 open-loop prepaid card over just 37 percent that would select a four-day, all-inclusive vacation (valued at far more) and 12 percent that would pick $1,000 in merchandise credit from a catalog.

Employers benefit from the flexibility of choosing a variety of prepaid solutions, depending on the need. Single-load prepaid cards are ideal for one-time recognitions such as service anniversaries and annual bonuses. Reloadable prepaid cards can be reloaded with funds, and are great for ongoing employee performance and incentive programs such as hitting weekly sales objectives or daily efficiency goals.

Businesses can extend this concept beyond internal employees to reward and incent partners and contractors, too.

A common example is multi-level marketing companies that reward their contract associates with ongoing perks to drive sales results or retail sales associates who may also have daily sales objectives. Cards can even be company branded to drive awareness and affinity when the card is used.

Reloadable prepaid cards work particularly well to reward and maximize timely behaviours. Consumers who participate in regular surveys, product trials or other activity; or business partners who are compensated on sales, service or other operational milestones can be immediately recognized. Immediacy has proven to be a strong motivator across all audiences – the right reward at the right time.

Campus Payments 3

The higher education segment hasn't updated their payments processes in decades, and school administrators are under pressure to reduce costs and improve the student experience.

Institutions across North America issue scholarships, grants and bursary payments by cheque, requiring students to go to a bank or use a cheque-cashing service in order to obtain cash to pay for books, meals and other expenses. A lost cheque means it could take several months of red tape to replace it. Unlike cheques, prepaid cards can come with a zero liability policy and, in many cases, emergency card replacement.

In the U.S., the regulatory environment for campus prepaid programs is uncertain. The Consumer Financial Protection Bureau and the Department of Education have finalized rules that govern disclosures, overdrafts, and in the case of the Department of Education, fees, making many U.S. program managers rightfully hesitant to invest.

Additionally, the recent election results mean that existing regulations may be overturned in the near future, but no one is sure what the future regulatory landscape looks like. But Canada's stable and transparent regulatory framework provides a much less complex path forward.

There are hundreds of universities in Canada serving more than 1.7 million students who spend on average CA$6,000 annually on tuition alone – much of which is paid via cheque.

That equates to at least a CA$10.2 billion market riding on the rails of a very outdated payment method.

A $10.2 billion college campus market riding on the rails of a very outdated payment method.

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Remember, the average cheque costs CA$2 – $3.85 per cheque more to originate, administer, reconcile, clear and settle than the average electronic payment. This cost can increase exponentially when one or two physical signatures are required on the physical cheque.

Canada is also a top-ten destination for international students, and welcomes more than 300,000 international students each year, a portion of whom attend English as a Second Language (ESL) schools in major metro areas like Vancouver, Montreal and Toronto. These students need a secure, easy way to pay school and living expenses and need to receive funds from family abroad more efficiently.

Prepaid is a more secure, convenient and timely solution for both open-loop prepaid cards that carry funds for expenses like tuition, room and board, or more restricted campus cards that limit spending to university properties and often a limited number of nearby businesses. This is another opportunity to leverage a RAN (restricted authorization network), where payments can be limited to a specific list of approved providers, such as book stores and campus dining affiliates.

Cards can be funded by both the institution or other third parties, such as families or employers. These options are especially appealing for international students whose families can add additional funds to the cards far from home.

Some organizations are also exploring a combined identification/reloadable card that can be used for meal plans, books, intramural sports fees, etc.

Because campus programs are still a fairly new concept in Canada, program managers have open opportunity to build profitable programs from the ground up, which can later be exported to the United States once there is more regulatory clarity around such programs.

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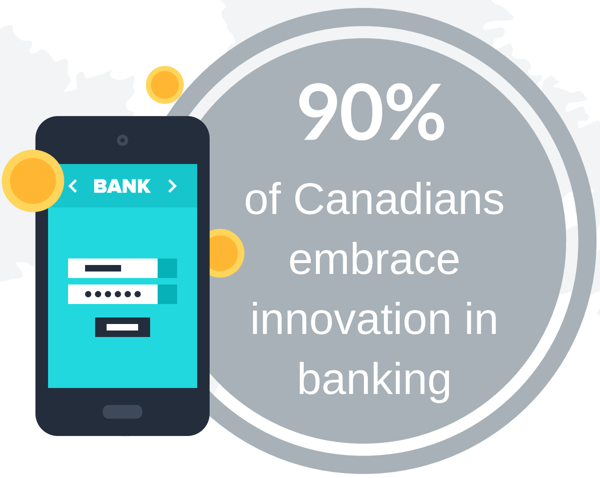
Going to Market in Canada: Get to know the financial system and regulatory framework

Canada’s payments and banking system has several notable differences when compared to the U.S. financial system, beginning with a significantly more consolidated arrangement of financial institutions.

This takes the form of Canada’s big five federally-chartered and regulated banks, which focus on deposit-taking and commercial lending activities. Additionally, Canada's financial system has 44 independent trusts, which can be incorporated and regulated at the federal or provincial level; and other key players, who offer deposit services, mortgage products, savings accounts as well as commercial credit, debit and prepaid card programs. Like the U.S., Canada also has credit unions, which are regulated at the provincial level and owned by their members.

Market entrants should also know that not all financial institutions work within the prepaid space, and not all federally-regulated prepaid issuers are banks. The prepaid regulatory structure in Canada also varies considerably from that of the U.S. Its modern prepaid payment product regulations were introduced in Canada just over two years ago, in May 2014. But don’t mistake this relatively young ecosystem for a niche application. Financial institutions and consumers alike are ready to embrace the benefits of prepaid and other innovative financial services.

In fact, the Canadian Bankers Association reports that 90 percent of Canadians embrace innovation in banking; and according to the MasterCard Payments Readiness Index, Canada is the world’s second-most “ready” country for mobile payments.



Meanwhile the Canadian Prepaid Providers Organization (CPPO) reports that the majority of Canadian consumers are aware of and satisfied with prepaid products. It’s clear that Canada is accepting of new ways to pay, like open-loop prepaid cards, and is ready for innovation in prepaid payments.

U.S. prepaid program managers should see Canada as a unique expansion opportunity because they can build or rebuild programs more efficiently and potentially more profitably than they can at home.

“Even if the market is smaller, the ROI on a new prepaid program has the potential to be better in Canada because of the new opportunities and the ability to build a program with a regulatory environment in mind,” notes Ben Jackson, director, prepaid advisory service for Mercator Advisory Group, who also noted that program managers have invested many resources to retrofit or catch up to stay in compliance with U.S. regulations.

“Even if the market is smaller, the ROI on a new prepaid program has the potential to be better in Canada because of the new opportunities and the ability to build a program with a regulatory environment in mind.”

-Ben Jackson, Mercator Advisory Group, Director of Prepaid Advisory Service

Unlike other international markets, Canada is well-suited for U.S. investment due to the geographic and cultural commonalities, not to mention the value of the U.S. dollar in Canada. But, program managers still need experienced local experts to navigate market entrance and they should not go at it alone. Instead, it’s best to seek expert assistance in application and interpretation of the regulations from issuing institutions like Peoples Trust Company.

Getting Started

Program managers should incorporate the following key elements in their go-to-market roadmap to ensure efficient compliance with all Canadian regulatory requirements:

1. **Set a realistic timeline for product launch.** Even the most nimble fintech company will quickly learn that launching a new prepaid-based product in any major financial market is a significant undertaking. There are many cooks in the kitchen, and many factors are interrelated. Be sure you have a solid sense of all of the players and all of the many requirements before setting a launch date.

2. **Partner with a federally-chartered issuing institution** (a Canadian bank or trust company) who can help you navigate the national and provincial requirements. It's imperative to engage a partner early in the process to ensure compliance across the geographic scope of your market offering.

3. **Seek credible referrals for other key partners** such as payment processors, card manufacturers and others who are essential to a successful program launch. Many prepaid regulations center around disclosures, just like in the U.S. Experienced prepaid program managers know that it takes a village to implement those disclosure requirements correctly. Ensure your go-to-market partners are local, and have extensive experience in implementing prepaid programs.

4. **Determine if your program will be card-centric or card-less** (mobile/virtual, etc.). Innovative electronic payment systems that ride on prepaid network payment rails must still follow prepaid regulations, even if a physical card is not involved. Be sure you get a detailed interpretation of how the rules apply to various form factors of your program.

5. **Get familiar with fee rules.** Certain conditions must be met before cardholder fees can be applied or increased or be imposed after issuance. Be sure you understand the requirements and implications of failing to comply. Your issuer of choice will have ultimate responsibility for compliance with the rules and regulation and should therefore be proactive, accessible and engaged, to provide experienced insight and guidance to help ensure program success.

6. **Adapt program to bi-lingual requirements.** Canada has two official languages, English and French, which understandably creates federal and provincial nuances program managers must take into account.

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Conclusion: Why Prepaid in Canada Now

Canada is at the forefront of electronic payments and fintech, with an emerging insurtech sector, and ready to replace cheques with more efficient, convenient and secure prepaid payments programs. It's clear there's fertile ground for innovation and growth.

There is opportunity to challenge and improve existing business practices and remove friction. Prepaid program managers from around the world can seize the opportunity to design a compliant, profitable program in Canada from the ground up.

The global economy also currently supports American programs looking to diversify their exposure to economic conditions, with favorable exchange rates, and for companies looking to gain experience with cross-border payment scenarios.

There's no better way to get your feet wet than in a nation that shares time zones and a common language and cultural qualities with the U.S.

Peoples Group

Let's Connect

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