

**Canadian Prepaid Providers Organization
(CPPO):**

**Written Submission for the Pre-Budget
Consultations in Advance of the 2023 Budget**

February 10, 2023

Recommendations

- **Recommendation 1:** That the Government of Canada amend the regulations associated with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA) to clarify the provisions covering prepaid payment products.
- **Recommendation 2:** That the Government of Canada include prepaid technology among the methods used to disburse federal benefits and support payments to improve efficiency in government operations and enable payment recipients to avoid the costs, inconvenience, and limitations associated with paper cheques.
- **Recommendation 3:** That the Government of Canada amend the *Canadian Payments Act* to expand membership in Payments Canada to enhance competition and allow broader access to Canada's payments system.

The Canadian Prepaid Providers Organization ([CPPO](#)) is a not-for-profit organization and the collective voice of the open-loop prepaid payments industry in Canada. The association is supported by major financial institutions, card networks, program managers and fintech innovators. The CPPO is focused on awareness and education to help consumers, governments and businesses understand the value of prepaid platforms and to enhance the experience associated with these solutions.

The Evolution and Growth of Prepaid Payments in Canada

Open-loop prepaid payments products serve as a catalyst for financial services innovation in Canada and represent one of the biggest growth segments in the industry. The Canadian open-loop prepaid card market continues to grow at a rapid pace and is expected to exceed CA\$17 billion in annual loads by 2025. Total loads on all Canadian open-loop prepaid card accounts grew from an estimated CA\$7.2 billion in 2020 to about CA\$8.5 billion in 2021, an 18 per cent increase and up 76 per cent since 2019. This growth is expected to continue, with the prepaid market project to exceed CA\$17 billion in annual loads by 2025.¹

While the COVID-19 pandemic and prepaid providers' quick pivot to digital use cases and e-commerce were key drivers for prepaid growth, it is expected that many of these trends will continue post-pandemic to meet the expectations of the digital-savvy Canadian consumer. Certain digital-first programs, such as consumer-funded general purpose reloadable (GPR) prepaid card programs leveraged by Canadian digital challenger banks continue to gain traction among Canadian consumers looking for chequing account alternatives or for a better, cost-effective way to bank. Coupled with next generation features and functionality such as earned wage access (EWA), quick and efficient digital account opening (DAO), accessible fee and rate offers, and creative, forward-thinking money management capabilities, Canadian digital challenger banks are becoming more competitive with incumbent financial institutions.

Corporate-funded prepaid programs are also expected to become more relevant post-pandemic. The use cases that have gained prominence within the market employ a wide range of value propositions while laying the foundation for further innovative offerings. In B2C and B2B instances, this includes using prepaid for payroll, employee benefits and incentives, insurance claims, accounts payable and on-demand delivery. Without effective regulatory oversight of these products, however, their continued emergence could be stifled.

Amending Canada's AML regime to support prepaid innovations

The most immediate area where regulatory change is required to support innovation and expanded issuance of prepaid products is Canada's supervision of prepaid products from an anti-money laundering perspective. In June 2019, the Government of Canada finalized amendments to the Regulations associated with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA) impacting FINTRAC's supervision of prepaid payment products in Canada.

Under the Regulations, the new definitions of "prepaid payment product account" (PPPA) and "prepaid payment product" (PPP) are broadly drafted. The effect is that the Regulations apply to any PPP that is tied to an account that permits funds that total C\$1,000 or more to be added to the account in a 24-hour period or a balance of funds of C\$1,000 or more to be maintained in

¹ The Canadian Open-Loop Prepaid Card Market: 2021 Results and Forecast Update, Aite-Novaverica Group. April 2022.

the account. The broad drafting of these definitions has significant unintended consequences. Although these requirements are only drafted to apply to financial entities and life insurance companies that issue prepaid products, given how prepaid programs are structured, this approach has had trickle-down ramifications for everyone involved in the prepaid industry including program managers, processors, retailers, and ultimately all corporate entities and consumers who purchase prepaid products.

There are four practical use cases we would like to bring forward that illustrate how the improper drafting of these regulations is having real-world implications on prepaid issuance in Canada. To provide a perspective on why the regulations should be amended, these use cases are discussed in more detail below.

1. Reward Programs

While the Regulations (in the definition of a “prepaid payment product”) contemplate an exemption for prepaid payment products issued in connection with a “retail rebate program” the carve out as drafted is quite limited.

Consider a rewards program offered by a hotel chain, ABC Hotels. ABC Hotels wishes to reward its frequent guests, for example, a guest who stays seven nights in any calendar year, by providing them with a \$50.00 prepaid Mastercard that can be used anywhere that Mastercard is accepted. The cardholder will have no ability to load or reload the card; only ABC Hotels will be able to do so. In order to facilitate such a program, ABC Hotels will enter into an agreement with a program manager for the distribution of the prepaid cards that are issued by a financial entity. To establish the program, ABC Hotels will be required to prefund an account to cover the value of cards expected to be issued under the rewards program. The amount loaded to this account will obviously exceed CAN. \$1,000. Accordingly, the account will constitute a prepaid payment product account as defined in the Regulations. In that regard, a “prepaid payment product account” is defined in the Regulations as an account...*that is connected to a prepaid payment product and that permits funds that total \$1,000 or more to be added the account in a 24 hour period or a balance of funds of \$1,000 or more to be maintained.*

Accordingly, pursuant to the Regulations, when the account is established, the financial entity (through the program manager) will be required to perform full KYC on ABC Hotels as the account holder and obtain all requisite information under the PCMLTFA in respect of the establishment of a prepaid payment product account. However, as the Regulations are currently drafted, because each card issued for the reward program will enable to holder to obtain “electronic access” to the prepaid payment product account by use of the prepaid payment product, it will be considered a “prepaid payment product” under the Regulations. It follows then that each guest of ABC Hotels that is issued a prepaid payment product under the program would be considered an “authorized user” of the prepaid payment product. That is because an “authorized user” is defined in the Regulations to mean a person who is authorized by the holder of a prepaid payment product account to have electronic access to funds available by means of a prepaid payment product that is connected to it.

As a result, in order for the ABC Hotels’ guests to get the benefit of the prepaid card as a reward, the financial entity would be required to obtain (and keep records for five years) of the guest’s name, address, the nature of their principal business or occupation and their date of birth (the “**Personal Information**”). The financial entity would also be required to verify the authorized user’s identity in accordance with the Regulations. This would entail pulling a credit report, or requiring some type of online identity verification. Moreover, section 116(1)(a)(ii) of the Regulations would require the financial entity to undertake a PEP determination on the authorized

user. In the event that the cardholder was a PEP or a family member or close associate of a PEP, additional requirements would apply.

We believe these requirements are inappropriate when considering the nature of the product. In this use case, the prepaid card cannot be used by the end user for money laundering as the end user has no ability to use their own funds to load onto the card. The card can only be loaded by ABC Hotels. As such, there is no money laundering risk. We note that the essence of money laundering is to disguise the source of money or assets derived from criminal activity. It is impossible to launder money where a person is not able to use their own money.

Accordingly, from a policy perspective, there is no reason to have rewards programs of the kind of described above (where the end user has no ability to load funds and it is a pure corporate load program) subject to the Regulations. It creates onerous requirements that satisfy no underlying policy objective. Moreover, the requirement for financial entities to maintain records of sensitive personal information on authorized users where there is no underlying policy support not only gives rise to potential data breach issues, but is also contrary to the principles of privacy law.

2. Reimbursement Programs

Another use case is in respect of employee reimbursement programs. Consider a company with a sales force that travels on a frequent basis. In order to fund the employees' travel (hotel/transportation/food), many employers provide their employees with a prepaid card funded with a fixed amount of funds. We note that the use of prepaid cards for reimbursement expenses allow employers to manage expenses and to control and track spending in real time. When the employee returns from their travels, the employer can retrieve the funds from the card. The employee would not have the ability to load or place any funds on these reimbursement cards.

As an alternative use-case, the employee may also pay for all of their expenses on an out of pocket basis when they travel. When they return from their trip, they provide the employer with receipts and the employer refunds the employees expenses by providing the employee with a prepaid card loaded with an amount that reimburses the employee for their out of pocket payments.

In both of these scenarios, the employer would be required to provide the financial entity (either directly or through a program manager) with funds to load the card accounts thereby creating a "prepaid payment product account" as defined in the Regulations. In addition, the cards issued to employees, would be prepaid payment products, and the employees would be "authorized users" as defined in the Regulations. Accordingly, in addition to performing KYC on the company (which is appropriate) the Regulations, as currently drafted, would require the financial entity to obtain Personal Information on the employees as well as to verify their identity and undertake a PEP determination.

Like the structure for the rewards program, for reimbursement programs, the employee would have no ability to load any funds on the cards; all cards would be loaded by the employer funding the prepaid payment product account at the financial entity. Accordingly, because the employee cannot load any of their own funds onto the card, they are unable to use the card for money laundering purposes. As such, making cards that are used for corporate reimbursement programs that can only be corporate loaded subject to the PCMLTFA is not in keeping with the policy objectives of the PCMLTFA and there is no money laundering rationale to support such regulation.

It is a basic Financial Action Task Force (“**FATF**”) principle that regulations should apply a risk-based approach to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified. According to FATF, “This approach should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime”. With respect, we believe that requiring the collection of Personal Information, verification of identity and undertaking a PEP determination in these circumstances runs counter to this basic FATF principle.

3. Incentive Programs

Another use case involves the use of prepaid cards for incentive programs. Consider by way of example, a Mazda car dealership. Each month, the manager of the dealership wants to incentivize its top sales performers by giving them a bonus in the form of a prepaid card. Using this use case, the top salesperson would get a \$500 prepaid card, the second place salesperson would get a \$250 prepaid card and the third place salesperson would get a \$100 prepaid card.

To offer the program, the dealership would need to establish a prepaid payment product account at the financial entity issuer. As such, full KYC would be performed on the dealership, as is appropriate. However, all employees receiving cards would qualify under the Regulations as “authorized users”. Therefore, before any cards could be issued to them, the financial entity would be required to obtain the Personal Information, verify identity and make a PEP inquiry.

We believe this is unreasonable. As in the case of the previous use cases discussed, the prepaid cards cannot be used by the employees for money laundering as the recipients are unable to load any personal funds onto the cards. Instead, the cards can only be used to receive the incentive payouts and the cards can only be loaded by the dealership.

It should be noted that with these types of programs (and with the reimbursement programs noted in Use Case 2 above) the card itself may not be a one-time use card but rather may be a reloadable card so that a new card is not required every time that a salesperson qualifies for more than one incentive bonus. Instead, for ease of administration, the amount of funds awarded to employees can be reloaded directly onto the cards and they can receive available funds almost immediately. This also saves the financial entity (and the dealership) the cost and expense of having to issue and activate new PIN enabled cards each month which carries a significant cost. The important thing to note, is that while these cards can be reloaded, they can only be reloaded by the dealership that is the corporate sponsor of the program. As such, the nature of the money laundering risk does not change; there is no ability for a salesperson to use the cards to launder funds as they do not have the ability to load funds onto the cards.

4. Class Action Settlements

The fourth use case is using prepaid cards to pay out plaintiffs under class action settlements. To provide some context, when a class action is settled (or a court order is made directing the defendants to pay members of the class damages) there is a very large administrative element to the payout of the settlement. Class members may be located all over the globe and sending cheques or making distributions to a bank account (which would require the bank account details of every class member) is not a practical or cost-efficient solutions.

As such, it is common to use prepaid cards to provide the settlement proceeds to class members. In these circumstances, plaintiff’s counsel will usually appoint an administrator to arrange for the distribution of class action proceeds. Alternatively, the court may appoint an administrator (often

an accounting firm) to assist in the distribution of the settlement proceeds in accordance with agreed and court approved terms. The use of prepaid cards to distribute class action funds is an efficient and effective way to distribute settlement proceeds. Cards can be distributed digitally which eliminates the need to mail cards to plaintiffs.

As is the case in the previous examples, in the current context, the pool of funds that is deposited with the financial entity and used to settle the claim would be viewed as a prepaid payment product account under the Regulations thus requiring the claims administrator to collect Personal Information and verify the identity of every class member before they can be issued their payout. Sometimes class action payments can be for very small amounts. Again, as in the previous cases, prepaid cards used for these purposes have no money laundering risk. All amounts paid to plaintiffs by use of the prepaid cards are done pursuant to a court order and recipients of the prepaid cards will have no ability to load funds onto the prepaid cards. As such, from a policy perspective, there is no reason for these cards to be subject to the regime.

The (in)ability to launder funds

The essence of these use cases revolves around the fact that for there to be the ability to launder funds, individuals would be required to be able to load funds on the cards. For these programs, only the sponsoring corporate entity can load or reload the cards. Cardholders have no ability to do so and have no control over how much is loaded on their card and when the funds are so loaded. From an AML perspective, as these cards have a very low risk of money laundering, it seems that there is limited underlying policy benefit to regulate these types of cards.

As the introductory language in the PCMLTFA provides, the object of the PCMLTFA is to detect and deter money laundering and terrorist financing. In these cases, we believe that the costs of regulating the cards—which include not only operational costs but also the invasiveness of collecting significant levels of personal data for very low-risk products—is not commensurate with the benefits. In addition, the AML risks of these cards are decidedly lower than an anonymous individual purchasing gift cards up to \$999 in a retail setting because for these programs, the sponsoring corporate entity is known and has completed a full KYC process. The provisions of the PCMLTFA are drafted to deal with general purpose reloadable cards, that mimic the features of a bank account. The same underlying policy rationale does not apply for corporate loaded prepaid cards.

CPPO's proposal

As such, we recommend that the definition of a “prepaid payment product” in the Regulations be amended. We believe this would help address the government’s concerns with corporate-funded programs while targeting only those PPPs that have elevated AML risks. Other comparable jurisdictions, including the US, Australia, and the European Union, have implemented AML regulations that focus on the maximum load amount of a PPP, and not a PPPA.²

If the Regulations or guidance do not clarify these issues virtually all holders of prepaid products—regardless of the amount the PPP holds or is capable of holding—will be required to

² The US Prepaid Access Final Rule requires KYC for cardholders if the maximum load value of the product exceeds US\$1000. Australia’s AML Act requires KYC for cardholders where the maximum load value of the product is AUD\$1000 or more and the cardholder can use the prepaid card to withdraw cash. The EU’s 5th AML Directive requires KYC on cardholders if the prepaid product’s maximum load value exceeds €150.

complete KYC validation. At-risk groups such as immigrants, seniors, and the underbanked are more likely to be intimidated by this process and leave funds unused or stop using prepaid products altogether. The widespread collection of individuals' data—where there does not appear to be a meaningful AML risk—also runs counter to Canada's privacy laws. Lastly, prepaid industry stakeholders who are unable to upgrade their systems or who find it too expensive will inevitably leave the market, shrinking Canada's prepaid industry and reducing the level of fintech innovation.

Improving government benefits delivery

In 2019, the Government of Canada issued more than 30 million cheques to disperse funds to citizens and business, leaving more than 800,000 unclaimed payments with an outstanding value of \$370M.³ The CPPO believes that prepaid solutions can address the challenges associated with paper cheques, while providing a high degree of flexibility and functionality for citizens receiving government benefits and other payments like tax returns.

Individuals who are issued cheques, in many cases, are either unbanked or underbanked. As a result, some of the most vulnerable Canadians are not able to receive government disbursements via direct deposit. The drawbacks of relying on cheques is well documented: it can be difficult to deposit funds, meaning recipients need to count on costly cheque cashing services; cheques can be lost or stolen; and funds are not immediately available for online purchases (this latter issue is particularly important for Canadians living in remote communities).

Open-loop prepaid cards provide citizens, businesses and the government with an efficient, secure, and flexible online payment option that does not have to be tied to a bank account (improving financial inclusion) and is far less expensive and more secure than a cheque. A government disbursement solution using a reloadable or single-use prepaid card ensures acceptance anywhere the payment network is supported (in-person or online), adheres to all applicable consumer protection, anti-money laundering (AML) and privacy requirements, and maintains the fraud and loss protection in accordance with the Zero Liability protections of the payment network.

With respect to disaster relief and emergency payments, field-issued prepaid cards can be tracked, and the funds can be managed to increase the utility of each relief dollar (e.g., funds can be monitored and restricted to specific geographies, merchants, or POS terminals). The government agency can control how and where funds are spent by recipients and the unused portion of support payments can be returned to government on expiry. All these controls cut down on the potential for fraud.

In response to COVID-19, governments and charities all over the world turned to prepaid products for an immediate, inclusive means to distribute benefits and emergency funds. The level of partnership between government, whether at the provincial or federal level, and FinTech companies in the prepaid ecosystem is trailing other countries. Given the drawbacks of cheques for this population, we believe the Government of Canada must leverage the innovation and enhanced capabilities of prepaid solutions to deliver financial assistance.

As the government examines how it provides financial supports and other government benefits, such as the new dental care benefit, agencies responsible for distributing financial support have the opportunity to leverage the benefits of new products like prepaid cards. Accordingly, we

³ Receiver General of Canada. Access to Information Request. 2020.

continue to encourage the Government of Canada to include prepaid technology among the methods used to disburse federal support payments. Such a change will provide recipients with an alternative that will allow them to avoid the costs, inconvenience and limitations associated with paper cheques.

Modernizing Payments Canada's Membership Structure

For some years the Government of Canada has been considering the need to modernize Canada's payments system and, accordingly, has undertaken extensive work to advance this goal. The inclusion of the *Retail Payments Activities Act* (RPAA) in Budget 2021 offered an important signal to industry and consumers of the government's commitment to implement payments modernization. As Finance Canada begins preparations for Budget 2023, the CPPO urges the government to build on this momentum by advancing other key legislative and regulatory steps that are prerequisites for modernizing our payments system.

Specifically, the CPPO believes that there is a pressing need to address the long-standing requirement to broaden membership of Payments Canada to allow access to new system participants. This could be achieved by amending the Canadian Payments Act (CPA) to establish rules to facilitate open, risk-based access to the Real Time Rail ("RTR"), as well as the proposed access to the exchange networks for electronic payments streams. Currently, only Payments Canada members can directly participate in the payments system, a fact which effectively excludes direct access for many new and innovative firms.

The CPPO encourages the government to build on the momentum arising from the RPAA to signal its intention to facilitate expanded membership in Payments Canada by amending the CPA in the forthcoming budgetary process. Such a change would enable access to the RTR and expand the universe of system participants to include new entrants that are able to deliver innovative, cost-effective products and services to consumers and merchants, which ultimately increases competition and access to financial solutions for Canadians.