



**Protecting users of
prepaid payment cards:
At the mercy of market forces**

Report produced by Option consommateurs
and presented to
Industry Canada's Office of Consumer Affairs

June 2008

OPTION CONSOMMATEURS

MISSION

Option consommateurs is a not-for-profit association whose mission is to promote and defend the rights and interests of consumers and ensure that they are respected.

HISTORY

Option consommateurs has been in existence since 1983, when it arose from the *Associations coopératives d'économie familiale* movement, more specifically, the Montreal ACEF. In 1999 it joined forces with the *Association des consommateurs du Québec* (ACQ), which had already pursued a similar mission for over 50 years.

PRINCIPAL ACTIVITIES

Options consommateurs has a team of some 30 employees working in five departments: Budgeting, Energy Efficiency, Legal Affairs, Press Room, and Research and Representation. Over the years, *Option consommateurs* has developed special expertise in the areas of financial services, health, agrifood, energy, travel, access to justice, trade practices, indebtedness, and the protection of privacy. Every year, we reach 7,000–10,000 consumers directly, conduct numerous interviews in the media, participate in working groups, sit on boards of directors, carry out large-scale projects with key partners, and produce research reports, policy papers and buyers' guides, including the annual *Toy Guide* in *Protégez-vous* magazine.

MEMBERSHIP

In its quest to bring about change, *Option consommateurs* is active on many fronts: carrying out research, organizing class action suits, and applying pressure on companies and government authorities. You can help us do more for you by becoming a member of *Option consommateurs* at www.option-consommateurs.org

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EXECUTIVE SUMMARY

Context of research

Canadians are great fans of electronic modes of payment, and the statistics on the subject confirm this. They have on average, close to two credit cards each, and make 3.4 billion direct payment transactions with their Interac cards.¹ Moreover, there are 1631² automatic teller machines per million inhabitants in Canada, one of the highest concentrations in the world.

In this context so conducive to electronic transactions, new products are constantly emerging and attempting to become popular in their turn. Among these are prepaid Visa and MasterCard cards, known as open loop, refillable, or prepaid cards, that are trying to penetrate the Canadian electronic payment market.

These cards are distributed by various types of businesses: banks, stores specialized in fast cheque cashing, and “lease to buy” stores; until very recently, they were distributed by the television company MuchMusic. They are even available directly over the Internet.

As with debit cards, but without a bank account, the consumer only uses the money he has deposited directly into his card. Just like credit cards, these cards are accepted everywhere the logos of Visa and MasterCard are found. In short, Visa and MasterCard prepaid cards are a marriage of the characteristics of Canadian credit cards and debit cards.

That being said, the advent of this new mode of payment raises many questions. What is the state of this market? What is the legislative framework regulating the use of these cards? Why do consumers do use them? Do they encounter any problems once they have used them? The aim of this project is first of all to understand the motivations of the users

¹<http://www.interac.ca/media/stats.php>

² <http://www.interac.ca/fr/media/stats.php>

of prepaid cards in Canada, to record the difficulties these cards can cause, then propose solutions.

Methodology

We began by defining the characteristics, the actors and the state of the North American prepaid card market. We attempted, among other things, to find out how popular this product is in Canada and the United States.

Next, so as to better understand the legislative framework of this electronic mode of payment, we examined the Canadian regulations. We then proceeded to a study of the legislative framework in the United States and France for the purposes of comparing the legal protection that consumers enjoy in those countries to the situation in Canada.

Then, to find out more about the obligations to which consumers and financial institutions agree regarding the use of prepaid cards, we analyzed the contents of the contracts of certain pre-paid cards sold in Canada.

Then, to identify the problems encountered by consumers in using prepaid cards in Canada, we contacted every Canadian organization whose role is to inform and protect consumers.

Finally, to understand the reasons motivating Canadians to use these cards, we organized two focus groups. The consumers we met with explained their reasons for using prepaid cards and related their overall experience with the use of this mode of payment.

Results

Our research indicates that Canadians have not shown much interest in using Visa and MasterCard prepaid cards in Canada. At the present time, there are only four financial

institutions in the country that issue this type of card. In addition to this, between 2007 and 2008, we recorded a termination of activities of more than ten of these cards in a market that never seems to have had more than fifteen.

In our opinion, it is the combination of access to low-cost bank accounts and the ease of obtaining a credit card for Canadian consumers that has significantly reduced the marketability of this product. The success of Visa and MasterCard prepaid cards in the United States, incidentally, seems closely related to the fact that several million Americans do not have access to a bank account.

Our examination of the Canadian federal legal framework reveals that a significant challenge awaits our legislators with regard to electronic payments, which includes prepaid cards. Although the federal government has constitutional jurisdiction over currency, it has not yet regulated plastic money. Canadians must therefore trust either the internal policies of financial institutions to settle their grievances or resort to often obsolete provincial laws. For example, *The Currency Act* does not state whether plastic money has the status of legal tender in Canada. It does not stipulate how long a company is given to correct billing errors. The law does not limit the responsibility of consumers in the event of PIN theft. The law does not regulate solicitation for electronic payment cards. The law does not regulate user fees for cards nor their expiry dates.

In an attempt to offset these legislative shortcomings, the Department of Finance periodically renews a voluntary code entitled *Canadian Code of Practice for Consumer Debit Card Services* a (once more voluntary) version of this code, but one that is extended to the entire range of electronic payments, will soon be formalized. However, our experience with the code since 1992 shows that it does not offer sufficient protection for Canadian consumers who use electronic payments. For example, various studies show that the *Canadian Code of Practice for Consumer Debit Card Services* is only very partially applied in terms of what it actually states and that it is very unequally applied from one branch of a financial institution to another. We therefore repeat the need for a legal framework in Canada for electronic payments. At the international level, on the other hand, a legislative effort has been under way for a long time. In 1978, U.S. legislators undertook to regulate electronic payments through the adoption of the

Electronic Funds Transfer Act. In 2001, France adopted the *Code monétaire et financier*, which also regulates electronic payments.

The Canadian Deposit Insurance Corporation (CDIC) will also have to consider the problem of prepaid cards. These cards resemble debit cards in several respects and can contain up to \$10,000 from the consumer's own pocket. However, to the surprise of the consumers we met during our focus groups, these sums are not eligible for protection by the CDIC. These consumers also wondered why similar payment products do not enjoy similar protection.

Admittedly, certain Canadian provinces have tried to patch the holes in the law left by the federal government with regard to electronic payments. The results, however, are not up to expectations. The framework naturally ended up lacking in uniformity due to the size of Canada and the fact that certain provincial laws still need to be updated. Quebec has shown leadership on this question by granting legal tender status to certain types of electronic payment – something that the federal authority, which has jurisdiction in currency matters, has yet to do!

Obviously, in an environment in which the State is generally out of the picture, the law of the strongest tends to prevail. Our analysis of the contractual conditions reveals, unsurprisingly, that companies write clauses that are potentially abusive. For example, companies allow themselves latitude with regard to the delivery of services that they themselves have promoted. They limit correction times in the event of misbilling to 30 days. They give themselves the right, for any reason and at any moment, to cancel the service sold or to change the charges of the agreement by posting only one notice on the Internet.

Admittedly, the low popularity of the product has reduced the number of difficulties associated with its use. When we contacted over thirty Canadian organizations whose role is to inform and defend consumers, we learned that consumers had made very few queries or complaints with regard to prepaid Visa and MasterCard cards. In fact, several of the organizations contacted quite simply did not know the product existed. Only the Financial Consumer Agency of Canada (FCAC), a federal organization with the mandate

of informing and protecting consumers of financial, products and services, reported some requests for information and complaints on this subject. Suffice it to say, however, that the small number of complaints received by these organizations does not mean that there are no pitfalls associated with the use of this type of product. Since we do not have access to the principal source of the complaints—those dealt with by the financial institutions—we are unable to evaluate the functioning of the product overall. Consequently, our research does not permit us to assert that there are no complaints about the use of these cards, just that the organizations whose role is to defend and to inform consumers did not receive any.

Also, because of a shortage of participants, it was quite difficult to organize focus groups in the Montreal region. In spite of well-targeted publicity, less than one in ten consumers participated in our two meetings. Nevertheless, these small groups allowed us to understand the participants' motives in using prepaid cards. They said that they use them to budget their spending, to avoid debt, for spending during travel and to protect themselves from Internet fraud. Their choice was primarily justified either by fear of over-indebtedness or by fraud or a combination of the two.

Those we met with state that they are satisfied overall with the use of the cards. They are accepted everywhere they want to use them and they are easily able to refill them. On the other hand, they expressed their dissatisfaction with the methods related to use of the cards. For example, they feel that user fees are high and poorly explained. They do not understand how foreign currency conversion fees are calculated. They do not like having to pay to contact the company's customer service department. They do not understand why the funds deposited on their card are not protected by the Canadian Deposit Insurance Corporation. Finally, the consumers we met with find the contracts for prepaid cards long and difficult to understand, which does not encourage them to read them.

All things considered, at the moment, it is the market that determines the rules of the game with regard to prepaid cards in Canada. The resulting situation is not advantageous for consumers.

Following analysis of the results, Option consommateurs makes the following recommendations:

Recommendations 1 to 3 are addressed to consumers.

Recommendation 1

Option consommateurs recommends that consumers be extremely vigilant in the use of electronic payments, including prepaid cards. Federal and provincial laws are sometimes obsolete, which could complicate matters in the event of litigation.

Recommendation 2

Option consommateurs recommends that consumers ask questions when they procure electronic modes of payment. They must inform themselves judiciously about the user fees for their products and about the guarantees proposed in the event of error or of fraud.

Recommendation 3

Option consommateurs recommends that consumers always keep a hard copy of the transactions that they make using electronic payments, at the very least for the period covered by their account statement.

Recommendations 4 to 7 are addressed to the federal government.000

Recommendation 4

Option consommateurs recommends that the federal government, in partnership with the provincial governments, harmonizes the current rules with the provinces and develops as of now a national regulation respecting electronic payments.

Recommendation 5

Option consommateurs recommends that this regulation limit the charges that can be billed by companies that offer electronic payments, including prepaid cards.

Inactivity charges should also be prohibited. A standard fee schedule should be considered for the industry.

Recommendation 6

Option consommateurs recommends that this regulation prohibit expiry dates on all types of electronic payments that entail renewal charges for consumers.

Recommendation 7

Option consommateurs recommends that there be a national regulation that obliges companies that offer electronic modes of payment to provide a version of their contracts in clear, simple language.

Recommendation 8 is addressed to the Canadian Deposit Insurance Corporation (CDIC).

Recommendation 8

Option consommateurs recommends that the CDIC review the coverage of certain types of deposit. Deposits made to a prepaid card must be insurable, in the same way as deposits made to a chequing account.

Recommendations 9 to 17 are addressed to the provincial governments.

Recommendation 9

Option consommateurs recommends that companies be obliged to indicate all the charges that can be billed to consumers. Whenever the amount is determined by calculation, this should be explained in the contract and the account statement sent to the consumer so that he can verify the amounts that are billed to him. In the contrary case, the consumer should have the possibility of refusing to pay these charges.

Recommendation 10

Option consommateurs recommends that the limit for charges that can be billed by companies that offer electronic modes of payment, including prepaid cards, be regulated. Inactivity charges should also be prohibited.

Recommendation 11

Option consommateurs recommends that all regulations related to this domain prohibit expiry dates on electronic payment instruments.

Recommendation 12

Option consommateurs recommends that all regulations related to this domain oblige companies that offer electronic modes of payment to provide a version of their contracts in clear, simple language.

Recommendation 13

Option consommateurs recommends that the government of Quebec study contractual clauses that allow only a 30-day error correction period. This is far too short. Moreover, such contractual clauses may be in contravention of Section 2884 of the Civil Code of Quebec.

Recommendation 14

Option consommateurs recommends that provincial governments regulate unilateral modification clauses. Unilateral modifications to the terms of the contract that should be considered abusive are those made without a valid reason specified in the contract, or modifications made without adequate warning that do not give consumers enough time to terminate the contract.

Recommendation 15

Option consommateurs recommends that provincial governments prohibit clauses that lay down a firm contract for the consumer while the company is able to perform its obligations as it pleases.

Recommendation 16

Option consommateurs recommends that provincial governments prohibit any clauses that tend to limit the right of consumers to obtain compensation for any damage that they suffer in the event of total or partial or defective execution of a contractual obligation by a merchant.

Recommendation 17

Option consommateurs recommends that provincial governments carefully define termination of service clauses. They should prohibit clauses that make it possible for the company to terminate the contract in a discretionary manner without extending the same right to the consumer. Moreover, clauses should be prohibited that make it possible for the company to terminate the contract without giving reasonable notice to the consumer except in the event of an emergency.