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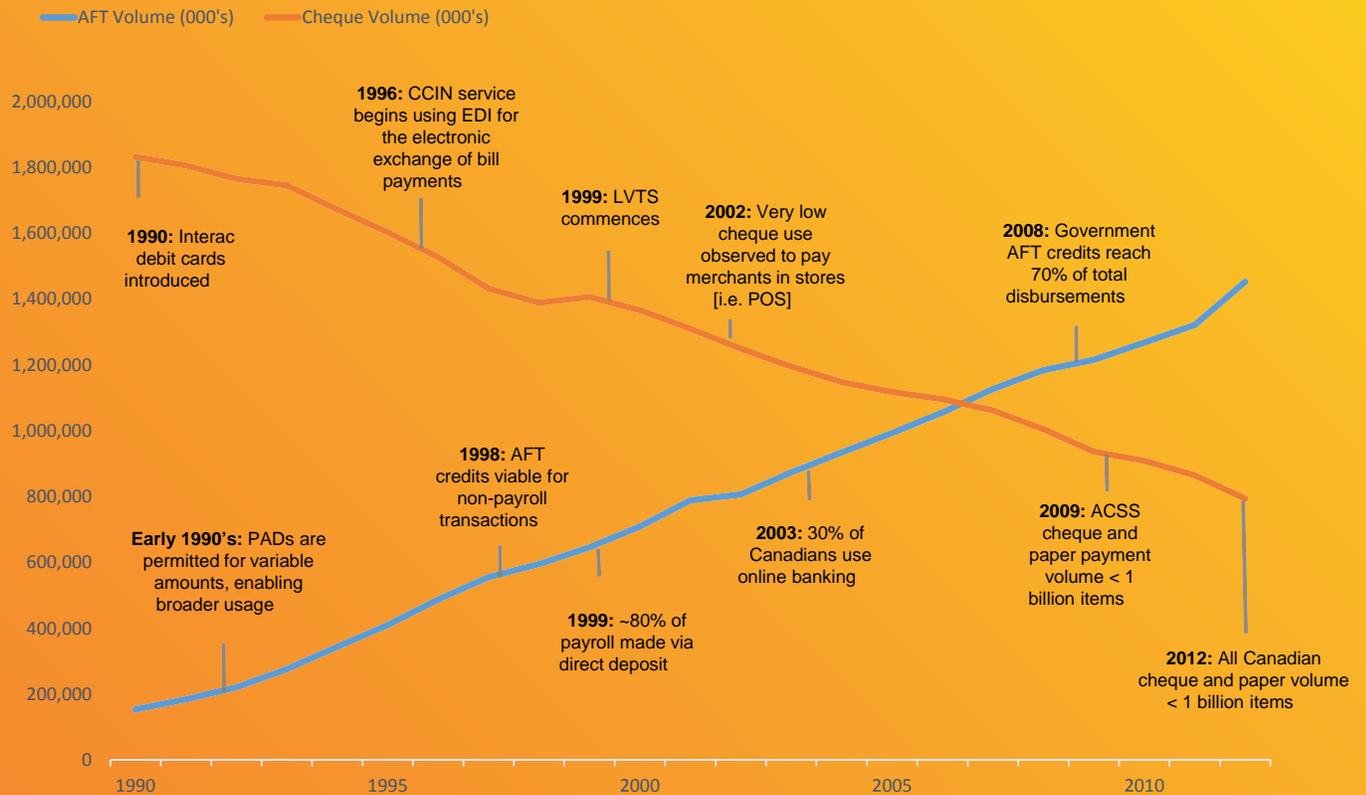
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The Role of Automated Funds Transfer Payments in Canada's Declining Use of Cheques

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AFT payments have served as an important substitute for cheques as a means of payment in Canada since the early 1990s, and particularly since 2002.



AFT payments have been a key contributor to the growth of electronic payments, adding over 650 million transactions worth \$1.5 trillion in electronic payments between 2002 and 2012.



Despite over two decades of electronic payments growth, cheque use in Canada, particularly by small and medium businesses, remains moderately high, at nearly 1 billion cheques per year. This presents an opportunity for continued AFT growth.



In the short-term, continued AFT growth is anticipated as more businesses and consumers use online banking platforms to initiate and receive payments, and as government cheque reduction initiatives continue to roll out.



For small businesses, education on the relative differences in terms of cost and on the security benefits of electronic payments could further the use of AFT.



Long-term AFT growth will depend on this payment method better meeting the needs of small and medium-sized businesses and local, provincial, and federal levels of government.

The successful conversion of AFT payments to the ISO 2022 payment messaging standard could have the greatest impact on reducing cheque use by these groups.

The Role of Automated Funds Transfer Payments in Canada's Declining Use of Cheques

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Abstract

This paper investigates the impact that the emergence of Automated Funds Transfer (AFT) payments has had on cheque use in Canada. We find that AFT payments have played a role in the declining use of cheques during the past decade. Nevertheless the use of cheques remains moderately high in Canada compared to other G7 countries. We follow this result with a discussion on factors contributing to short and long run growth. In the short-term AFT growth is anticipated to continue as more entities shift from paper to electronic payments. In the longer term AFT growth will depend on how AFT meets the needs of small and medium-sized business.

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Executive Summary

The Canadian Payments Association (CPA) underpins the Canadian financial system and economy by providing safe, efficient and effective clearing and settlement of payments. In support of this core purpose and our responsibility to ensure the continued modernization of the Canadian payments system, we seek clear insights into trends and developments in Canadian payments. One such area is the growth and evolution of electronic payments as Canadians continue to move away from cheques. In this discussion paper, we examine the role of electronic debit and credit payments, which are processed as Automated Funds Transfers (AFTs), in the ongoing decline of cheque use in Canada.

Background

AFTs are electronic direct credit or direct debit transactions used to move funds between accounts held at two different financial institutions. These are commonly known in Canada as direct deposits or pre-authorized debits (PADs) and are cleared by the CPA's Automated Clearing Settlement System (ACSS).¹ In 2012, nearly 758 million AFT credits worth about \$1.6 trillion cleared through the ACSS, representing over 25 percent of the total value of retail payments cleared through CPA systems.

Over the past decade, AFTs have been one of the fastest-growing electronic payment segments clearing through the ACSS, expanding by 200% in terms of annual value between 2002 and 2012. They have nearly replaced employee payroll cheques, dramatically reduced the number of cheques that corporations and governments disburse, and enabled some companies to collect almost all of their payments electronically. And yet, the role that AFTs play in the broad Canadian payments landscape is not widely known or understood. Further, the evolving relationship between Canadians' use of AFTs and use of cheques is largely unexplored in payments research literature.

This paper addresses these gaps by providing insights on the common uses of AFT payments, demonstrating the significance of AFTs in the overall shift to electronic payments, and identifying opportunities for further AFT adoption as a substitute for cheque use in Canada.

Methodology

A rich information set was assembled to carry out this study, consisting of both quantitative and qualitative data sources, including:

- ❖ Payments volume and value data extracted from the CPA's ACSS database;
- ❖ Public and proprietary data acquired from CPA members and stakeholders; and,
- ❖ Qualitative data gathered through interviews with a wide range of subject matter experts.

¹ Further information regarding the ACSS and clearing can be found on the CPA website, at www.cdnpay.ca

Key findings

Our research reveals strong evidence that:

- ❖ AFT payments have been a key contributor to the growth of electronic payments, adding over 650 million transactions worth \$1.5 trillion in electronic payments between 2002 and 2012.
- ❖ AFT payments have served as an important substitute for cheques as a means of payment in Canada since the early 1990s, and particularly since 2002.
- ❖ Despite over two decades of electronic payments growth, cheque use in Canada, particularly by small and medium businesses, remains moderately high, at nearly 1 billion cheques per year.

Future opportunities

Canadian cheque volumes (compared to other G7 countries) represent an opportunity for continued AFT growth. Several opportunities are identified to further transition portions of cheque use to AFT payments, in particular:

- ❖ The largest potential for further transition away from cheques and toward AFT appears to lie with business payments, where small and medium-sized businesses present a particularly sizeable segment for future AFT growth.
- ❖ Standardizing electronic payments and incorporating richer remittance information. The CPA's initiative to modernize Canadian payment messaging standards (based on the global ISO 20022 standard) is responding to the need among Canadian businesses and governments for more remittance information to support automated reconciliation and straight-through-processing.
- ❖ Bolstering the use of AFTs by small and medium-sized businesses by promoting online banking services and improved education.
- ❖ Migrating more government payables and receivables to AFT by encouraging provincial and municipal governments in Canada to emulate the federal government's cheque reduction initiative.

Conclusion

In the short-term, we anticipate continued AFT growth as more businesses and consumers use online banking platforms to initiate and receive payments, and as government cheque reduction initiatives continue to roll out. For small businesses, education in terms of cost and the security benefits of electronic payments could further the use of AFT.

Long-term AFT growth will depend on this payment method better meeting the needs of small and medium-sized businesses and various levels of government. The successful conversion of AFT payments to the ISO 20022 payment messaging standard could have the greatest impact on reducing cheque use by these groups.

1. Introduction

During the past two decades in Canada, use of cheques has steadily declined as individuals, businesses and governments continue to transition away from paper payment instruments toward electronic means of payment.¹ Since reaching a peak in 1990, total annual use of cheques and other paper items has fallen by nearly 60 per cent, from 2.3 billion to less than 1 billion cheques written in 2012.²

The CPA is keenly interested in understanding trends and developments in the Canadian payments landscape, and in supporting the growth of electronic payments in Canada.³ In this discussion paper, we investigate the role that increased adoption of electronic direct debit and direct credit payments have played in the ongoing decline in cheque use. In Canada, most of these payments are facilitated through Automated Funds Transfer (AFT) payments, which are cleared through the CPA's Automated Clearing and Settlement System (ACSS).⁴

The evolving relationship between Canadians' use of AFT payments and use of cheques is largely unexplored in the payments research literature. This paper addresses this gap by drawing on both quantitative and qualitative data, including annual AFT clearing volumes captured via the ACSS, public and proprietary data provided by select CPA members and stakeholders, and information gathered via interviews with subject matter experts. We find strong empirical and anecdotal evidence to suggest that AFT payments have served as an important substitute for cheques as a means of payment in Canada since the early 1990s, and particularly since 2002.

Despite the growth and ubiquity of AFT payments in Canada, the role that these payments play in the broader Canadian payments landscape is not widely known or understood. As such, this paper also generally aims to educate readers of the common uses of AFT payments, the significance of AFT in the overall shift to electronic payments, and opportunities for further AFT adoption as a substitute for cheque use in Canada.

The remainder of this paper is as follows. Section 2 discusses AFT payments and their common uses in Canada. Section 3 outlines our research methodology and Section 4 presents our research findings. Concluding remarks are presented in Section 5.

2. What are AFT Payments?

Direct debits and direct credits (referred to as "direct payments") are arrangements by which financial institutions move funds electronically between deposit accounts of payors and payees.⁵

¹ Canadian Payments Association (CPA) data indicate that electronic payments have grown to account for around 90 per cent of the total annual non-cash volume of payments made in Canada.

² The CPA estimates that use of cheques and other paper payment items (e.g., bank drafts, cashier cheques, coupons, etc.) peaked in 1990 at 2.3 billion items, falling to about 990 million items in 2012. This estimate includes "on-us" volumes.

³ The migration toward electronic payments presents a significant opportunity to reduce cost, improve processing speed, and enhance payment-related services like fraud detection.

⁴ Further information regarding the ACSS can be found on the CPA website, at www.cdnpay.ca

⁵ In the course of a payment, the "payor" refers to the party that is providing funds to make the payment, while the "payee" refers to the party that is receiving the funds from a payment. The focus of this paper is on

More specifically, *direct debits* refer to payments that are “pulled” by receiving parties (payees) from payors’ accounts, while *direct credits* refer to payments that are “pushed” from payors’ accounts to payees’ accounts. In Canada, direct debit and direct credit arrangements predominantly take the form of AFT transactions, which follow specific AFT messaging standards and rules, and which clear through the CPA’s ACSS.⁶

AFT Pre-authorized Debits

AFT debit transactions are commonly known as Pre-Authorized Debits (or “PADs”). AFT PADs are based on contractual agreements between payors and payees, allowing a payee to instruct its financial institution to retrieve funds from a payor’s deposit account at another financial institution. The CPA’s ACSS (and related rules and procedures) provide the framework to enable the movement of funds in this arrangement. AFT PADs are used by consumers and businesses⁷, and are typically set up to support recurring payment obligations such as insurance premiums, mortgage and other loan repayments. The four main uses for AFT PADs are shown in **Figure 1** below.

Figure 1: The Four Main Uses for Pre-authorized (AFT) Debits



cases where payors and payees hold accounts at two different financial institutions, necessitating a transfer of funds between the two financial institutions to effect settlement of a payment obligation.

⁶ The exchange and clearing of AFT payments is performed in accordance with CPA Rules and Standard 005. Exchange takes place through a CPA-facilitated service network, while clearing is performed by the ACSS. Payments that leverage AFT standards make up 80 per cent of the volume and 90 per cent of the value of all the direct credit and direct debit payments cleared via the ACSS. Most of the remaining direct payments follow the Electronic Data Interchange (EDI) standards. EDI is primarily used for B2B payments; however, CPA members also leverage EDI to exchange most of the bill payments moving to large billers. More detailed information on the rules and procedures governing the exchange, clearing and settlement of the different ACSS payment streams can be found at www.cdnpay.ca.

⁷ Businesses include financial institutions, which issue and receive AFT payments.

In 2012, nearly 700 million AFT PADs worth about \$573 billion cleared through the ACSS, representing 10 per cent of the total value of retail payments cleared through CPA systems. AFT PADs have become a preferred payment acceptance method over cheques for many businesses, as they offer predictability of payment receipt, relatively low-cost, faster processing following initiation, and a low degree of follow-up communications (e.g., collections) with payors. Modernization efforts, such as permitting re-presentation⁸, and the use of virtual agreements and e-signatures, have helped enhance the case for continued use of AFT PADS over the past 20 years.

AFT Credits/Direct Deposit Payments

AFT credit transactions are commonly referred to as “direct deposits.” AFT credits allow a payor to instruct its financial institution to deposit funds into a payee’s deposit account at another financial institution. Once again, the CPA’s ACSS (and related rules and procedures) provide the necessary framework to enable this deposit to take place. AFT credits are used by consumers, businesses and governments in Canada, typically for payroll purposes and other disbursements. The five main uses for AFT credits are described in **Figure 2** below.

Figure 2: The Five Main Uses for AFT Credits



Payroll

Wage and benefit payments paid to employees and benefit providers as part of employment compensation. It is estimated that payroll transactions make up about a third of the total AFT credit volume.



Government Direct Deposits

Government AFT credit payments to businesses and consumers, including pension, social security, tax refunds, and other disbursements. These items also account for about a third of AFT credit volumes.



Bill and Invoice Payments

Mostly person-to-business and business-to-business AFT credits, which are often initiated through online banking services and portals.



Business (and Financial Institution) to Consumer Payments (non-payroll)

Disbursements by businesses and financial institutions to individuals, for purposes other than employment compensation. These payments are gaining momentum in industries where individuals may receive multiple payments over time from a business. For instance, insurance companies use AFT credits to pay benefits and reimbursements, and financial institutions pay individuals dividends, pensions, annuities, etc.



Account Transfers

Customer initiated transfers of value between their accounts at different financial institutions.

⁸ If a PAD is returned due to insufficient funds, the payee may re-present the PAD (i.e. try the debit again) one more time in an effort to collect the funds, provided this is done within 30 days of the original transaction date. This provides an advantage for payees, as the payment could potentially proceed successfully without requiring further payee action.

In 2012, nearly 758 million AFT credits worth about \$1.6 trillion cleared through the ACSS, representing over 25 percent of the total value of retail payments cleared through CPA systems. AFT credits have also become a preferred payment method over cheques, as AFT credits offer businesses, consumers and governments predictable funds management, enhanced convenience, faster processing, and relatively low cost.

3. Research Methodology

This paper investigates the impact that the emergence of AFT payments has had on the use of cheques in Canada, within the broader context of gaining understanding of the shift from paper to electronic means of payment. A rich information set was assembled to carry out the study, consisting of both quantitative and qualitative data sources, including:⁹

- ❖ Payments volume and value data extracted from the CPA's ACSS database;
- ❖ Public and proprietary data acquired from CPA members and stakeholders;¹⁰ and,
- ❖ Qualitative data gathered through interviews with subject matter experts. Specifically, these data were gathered via ten structured expert interviews, complemented with supplemental information provided by experts who were unable to participate in a full interview. Subject matter experts consisted of key industry users of AFT and cheque payments, payment consultants, and CPA member financial institutions. Non-CPA member respondents included representatives from the payroll, real estate, insurance, utility, small business, payment service provider, payment consulting, and government sectors.¹¹

4. Research Findings

Key observations from the research are highlighted below.

A. AFT payments have been a major source of growth for electronic payments in Canada

Annual ACSS payments volume grew by 44 per cent in the decade leading up to 2012. Specifically, volume grew from around 4.5 billion items cleared in 2002 to 6.5 billion items cleared in 2012. This is the result of strong growth in electronic payments, which accounted for nearly 88 per cent of total ACSS payment volume in 2012 (**Figure 3**). Growth in electronic payments volume

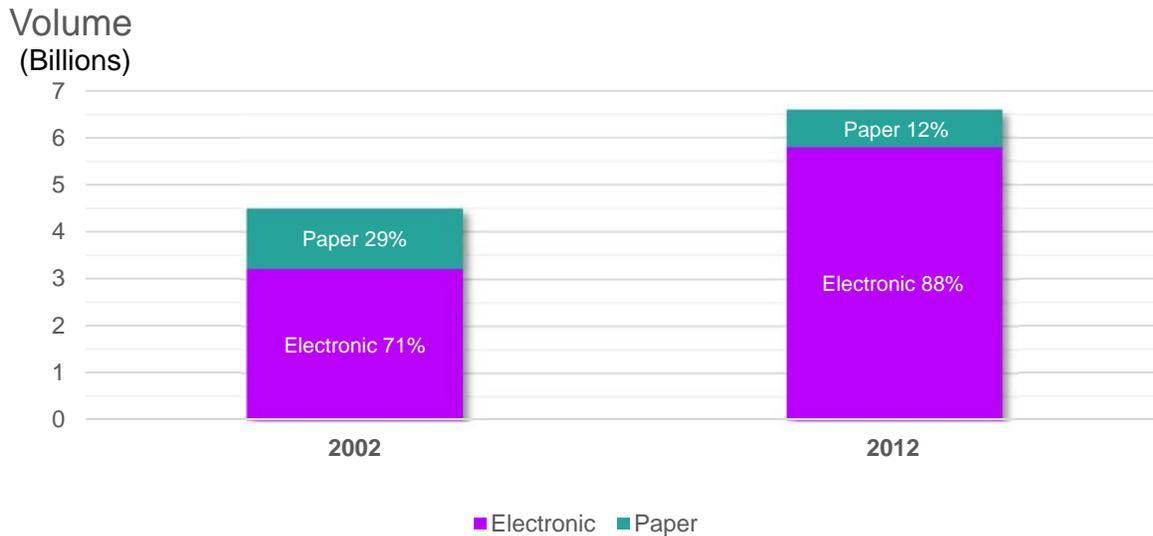
⁹ For ease of comparison, all quantitative data used in this analysis reflects end-2012 values, given that this was the most recent common collection date available for both CPA and proprietary third-party data at time of drafting. Notwithstanding, key trends identified in this paper are anticipated to have continued through to end-2014.

¹⁰ Including data from the *Canadian Payments Forecast (2013)*, Technology Strategies International (May 2013).

¹¹ Most of the responses and data were collected confidentially, so the contributors are not specified in the findings.

has been led by debit card transactions, where the number of these items cleared through the ACSS annually increased by over 1.5 billion items between 2002 and 2012.

Figure 3: Electronic payments growth in the ACSS (Volume shares between 2002 and 2012)

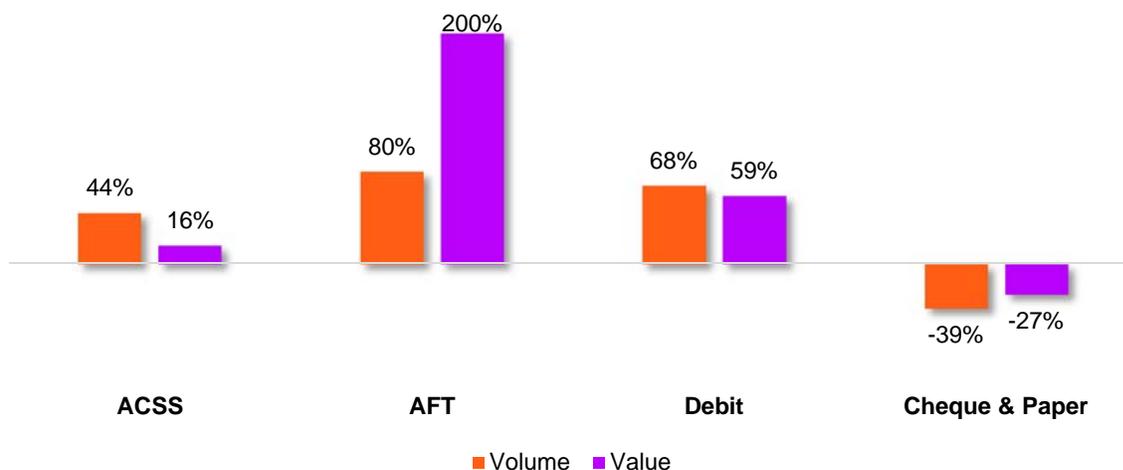


In addition to debit card transactions, AFT payments have also been a major contributor to the overall growth in electronic payments moving through the ACSS. Indeed, **Figure 4** below shows that AFT payments experienced volume growth that outpaced all other payment categories processed by the ACSS between 2002 and 2012. Specifically, the annual volume of AFT payments processed by the ACSS in 2012 was 80 per cent higher than in 2002 (i.e., 806 million items in 2002 compared to 1.45 billion items in 2012), while the annual volume of debit card transactions was 68 per cent higher in 2012 compared to in 2002 (i.e., 2.3 billion items in 2002 compared to 3.9 billion items in 2012).¹²

Also shown in **Figure 4**, AFT payments exhibited the highest growth rate among ACSS payment categories in terms of the annual value cleared, growing by about 200 per cent (i.e., from \$762 billion cleared in 2002 to \$2.3 trillion cleared in 2012). Moreover, in 2012, AFT payments accounted for about 40 per cent of the total value of payments cleared through the ACSS, compared to only 15 per cent in 2002 (not shown in **Figure 4**).

¹² “AFT Payments” include AFT debits and credits, and government AFT payments (which are not explicitly shared as part of the CPA web statistics). “Debit card transactions” include all of the POS transactions captured in the ACSS, including ABM and Interac Online transactions.

Figure 4: Key ACSS Electronic Payment Growth Rates (total growth between 2002 – 2012)*



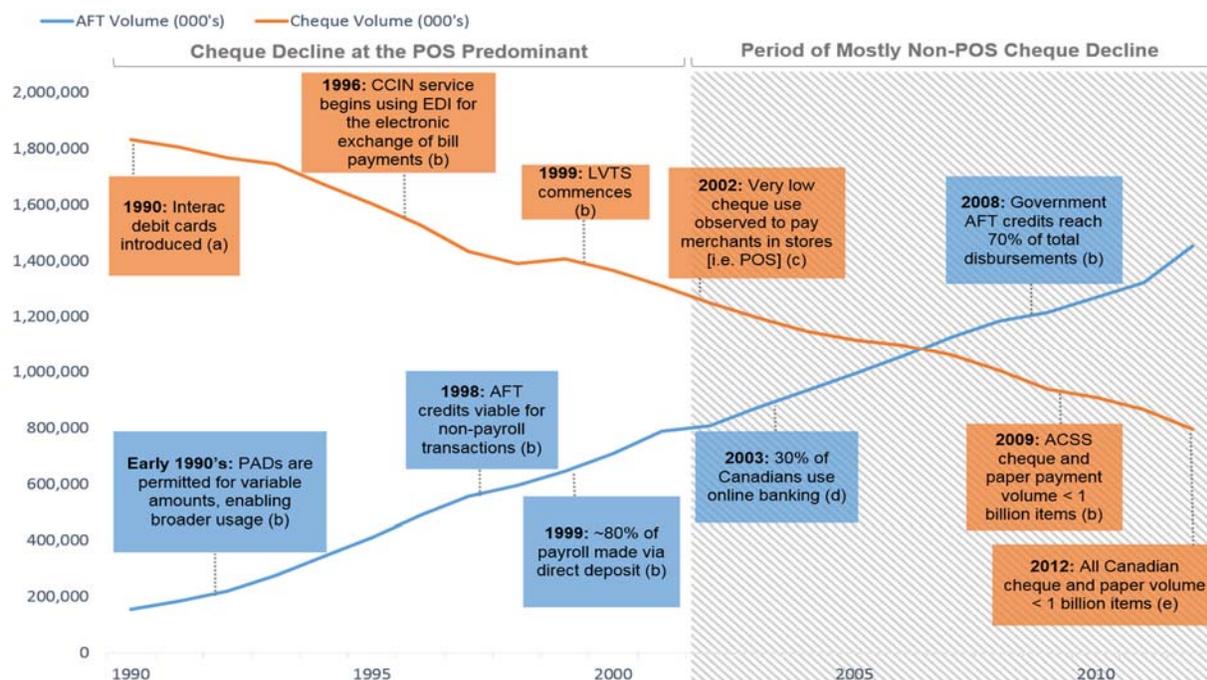
* ACSS value data reflects the impact of the elimination of paper payment items with value greater than \$25 million (in 2003). The value limit resulted in a reduction of about \$1 trillion worth of large value cheque and paper items clearing through the ACSS between 2003 and 2004.

B. There is evidence that AFT payments have contributed to the decline in cheque use, particularly since 2002

Since 1990, the number of cheques clearing through the ACSS has steadily decreased by 4 per cent, on average, per year. **Figure 5** below demonstrates the strong negative correlation between the number of AFT payments and cheque transactions cleared annually through the ACSS during the 1990-2012 period.¹³ As shown in **Figure 5**, the reduction in the number of cheques and other paper payment items cleared annually coincides closely with growth in the number of AFT payments. For instance, while the number of AFT payments cleared annually through the ACSS grew from 150 million to 1.5 billion during the period, ACSS cheque volume decreased from 1.8 billion to 790 million transactions.

¹³ Between 1990 and 2012, the correlation coefficient between cheque and AFT volumes is calculated to be -.98. This indicates a strong linear (though not necessarily causal) relationship between the two variables.

Figure 5: Timeline of Key Events Driving the Decline of cheque and Rise of AFT Volumes¹⁴



The data points to an even closer negative relationship between AFT and cheque use over the shorter period of 2002-2012 (i.e., shaded area of **Figure 5**). During the 1990s, AFT payments served as a substitute for cheques alongside debit and credit cards. However, by 2002 cheque use had virtually disappeared at the point-of-service (POS), as payment cards had become the primary non-cash means of paying merchants at in-store environments.¹⁵

Since 2002, with debit and credit cards dominant at the POS, cheques have been mostly used to facilitate *remote* (i.e., non-POS) consumer-to-business and business-to-business transactions, which are also the most common use cases for AFT payments. Indeed, for several high-volume payment uses, cheques and AFT payments are *the only available payment options*. Examples include payroll, government benefits (e.g., pension and social security payments), business disbursements, inter-FI account transfers, and loan repayments. In these areas, limited options

¹⁴ Sources: (a) Interac company milestones (interac.ca); (b) CPA historical archives and information provided by interviewees; (c) *Trends in Retail Payments...* Bank of Canada Review (2006) (d) *Study Suggests Online Banking is Tapped Out*, IT Business (2005); (e) CPA estimate.

¹⁵ *Trends in Retail Payments and Insights from Public Survey Results*, Bank of Canada Review (2006). This analysis observes that cheques were almost completely displaced at the POS by 2004 (by debit cards). We believe this trend had largely unfolded by 2002, providing a ten-year span to study cheque decline outside of the POS environment.

exist for using credit cards, cash, or e-wallet alternatives; hence, cheques and AFTs are viewed as directly substitutable means of payments.¹⁶

Against this backdrop, **Figure 5** shows that about 525 million fewer cheques were written annually in 2012 compared to 2002, while over 650 million additional AFT payments were processed annually during the same period.

Though this represents compelling evidence of a strong relationship between use of cheques and AFT payments in Canada, the data presented above do not necessarily prove that the emergence of AFT has *caused* the observed decline in cheque use. To help address this issue, specific information was compiled on the payments behavior of industry segments that have historically been intensive users of cheques.

We find that many organizations have been intentionally increasing their use of AFT payments as a means to reduce reliance on cheques.¹⁷ Our research identifies four main areas that appear to have contributed to the shift away from cheque use toward the use of AFT.

Payments to businesses and financial institutions using AFT PADs: The data suggests that since 2002, AFT PADs have had the single greatest impact on declining cheque use in Canada. Annual AFT PAD payments volume in the ACSS has grown by over 260 million total items since 2002, mostly in areas such as loan and mortgage payments, recurring payments (e.g., gym memberships), and business payments to service providers and suppliers.¹⁸

Payments initiated through online payment services: Businesses and financial institutions are increasingly accepting AFT credits originated from online banking and payment services platforms. Canadian financial institutions and some payment service providers (e.g., Telpay and PayPal) are also encouraging greater numbers of businesses and consumers to initiate payments in online environments (e.g., portals, web pages, and treasury management services) which leverage AFT transactions to facilitate payments. It is estimated that annual AFT clearing volume stemming from this segment has grown by at least 100 million transactions since 2002.¹⁹

¹⁶ For some other types of payments, such as bill payments and recurring fees, credit card payments serve as an additional option to AFT payments and cheques. However, due to lack of available data, the use of credit cards for bill payments was not analyzed. Similarly, cash might be used in a limited set of cases, such as for small businesses paying employees.

¹⁷ Numerous examples of such companies are provided in the Financial Executives International Canada report, *Electronic Payments in Canada, What's the Hold Up?* (2011). These companies include Telus, London Drugs, and I.M.P Group International Inc.

¹⁸ While not all of the growth can be attributed to cheque migration, one CPA member stated that PADs were the single largest area of AFT growth since 2002. A transition of loan re-payments (e.g., mortgage and automobile) from cheques to PADs helped account for a significant portion of the growth.

¹⁹ When government and payroll AFT credit items are removed from the AFT credit annual volume, what remains (over 200 million items) are mostly AFT credits for: 1) bill and other payments to the estimated 60,000 businesses that accept AFT credits; 2) volumes arising from payment service providers using AFT; and 3) business disbursements to consumers. Because a more precise number could not be determined for any of these three areas, a conservative estimate of "at least 100 million" is used to describe the portion that likely would have been originated in online environments.

Government payments: The federal government alone has migrated about 75 million (non-payroll) payments and disbursements from cheques to AFT direct deposit since 2002.²⁰

Payroll payments: Payroll payments moving to AFT have resulted in approximately 65 million less cheques being written per year since 2002. Today over 95 per cent of payroll is made via AFT credits, and payroll processors collect over 95 per cent of funds from employers via AFT debits.²¹ Most of the remaining volume of cheques in this category can be attributed to small businesses.

C. The Last Billion Paper Payments: Why Cheque Use Remains²²

Despite over two decades of electronic payments growth, cheque use remains moderately high.²³ In 2012, there were still about 990 million total cheques and paper items written, worth nearly \$3 trillion. This may reflect use cases that electronic payments have been unable to effectively address. This section offers a better understanding of what factors might be inhibiting further AFT growth in Canada, and the extent to which AFT payments could be leveraged to effectively displace remaining cheque volumes.

The research reveals useful insights regarding Canadians' continued use of cheques. Of note, 2012 was the first year that Canadians' use of cheque and paper payment items fell below 1 billion total items. Among these 990 million items, there were close to 600 million cheques originated by businesses and the various levels of government in Canada.²⁴ In addition, there were approximately 390 million personal cheques written by individuals, most of which were destined for businesses.

Between 2002 and 2012, cheque volume declined by 5 per cent each year, on average, with cheque origination decreasing faster for personal cheques than for business cheques (i.e., a 50 per cent decline and 30 per cent decline, respectively). Businesses are the largest contributors to the continued use of cheques in Canada, accounting for about half of all the cheques originated in

²⁰ High-level data was [published by the Government of Canada](#) and further refined by government payment experts. Estimates that include other levels of government would be considerably higher.

²¹ These figures are based on [Canadian Payroll Association statistics](#) (accessed November 2013), and information provided by a large payroll service firm, a large corporation performing payroll internally, and government payment experts. Together the sources show there were about 91 million payroll cheques in 2002 and about 26 million in 2012.

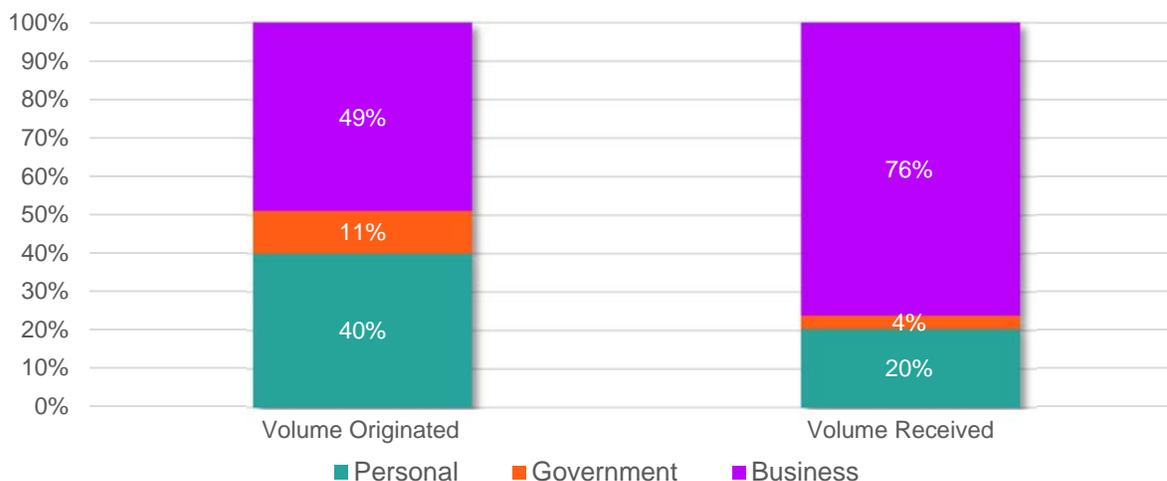
²² Estimates of remaining cheque use provided in this section are adapted from data from the following sources: CPA data, government payment expert cheque data, the TSI, *Canadian Payments Forecast – 2013* (June 2013)

²³ According to 2012 data on cheque use in the G7 countries (published by the Bank for International Settlements), only the US and France have a higher per capita use of cheques than Canada.

²⁴ Due to a lack of available data on the payment behavior of provincial and municipal governments, an estimate is used for this segment. Provincial and territorial governments combined receive and disburse more funds than the federal government (about \$700 billion per year versus \$550 billion). Given this information, a highly conservative estimate of cheque use for the programs, operations, and revenue collections of all the non-federal levels of government is applied in this analysis (30 million items or about 40% of federal government volumes).

2012. Businesses also received about 75 per cent of the cheques in 2012, indicating that cheque use is foremost an issue with businesses' preference to be paid using cheques (see **Figure 6**).

Figure 6: Estimated Users of Cheque and Paper Item Payments (2012)



Small and medium-sized businesses (i.e., those with less than 500 employees) account for 99 per cent of the total businesses in Canada²⁵, and consequently, a large share of overall cheque use. This was validated in a 2011 survey, which found that small and medium-sized businesses used cheques to make 61 per cent of the total value of their payments to suppliers, and received 50 per cent of the total value of their payments via cheques.²⁶ The same survey found that the top reason that these businesses continue to use cheques is a belief that electronic payment methods are not cost-effective to implement (i.e., the perceived costs to switch internal processes are too high).²⁷

On this point, several subject matter experts interviewed indicated that the full cost of cheque payments is not being recognized by many businesses (e.g., opportunity costs tied to processing time, postage fees, reconciliation, etc.), which tends to weaken the business case for transitioning to electronic payments.²⁸ Interviewees also suggested that cheques maintain an advantage in the minds of users due to familiarity, as many businesses have experience using cheques and have developed a sense of trust in the payment instrument. The interviews revealed that many small businesses do not have the same level of trust in AFT payments, due to perceived privacy and

²⁵ Industry Canada, *SME Research and Statistics: How Many Businesses are there?* (August 2013); www.ic.gc.ca/eic/site/061.nsf/eng/02804.html

²⁶ *Changing The Way We Pay: Getting the Transition Right for SMEs*, CFIB (2011).

²⁷ In the survey, 56 per cent of small and medium sized business respondents indicated that cost-effectiveness was the top reason for the continued use of cheques. The next most widely cited reason was “electronic payments are not commonly accepted in my sector”, provided by 36 per cent of respondents.

²⁸ This sentiment was recently echoed publically by a large Canadian bank; [BMO Promotes Electronic Payments to Corporate Customers](#), Forbes.com (April 2014)

security threats. As such, these businesses are not willing to share account information to enable AFT payments and instead continue to opt for cheques.

Interviewees also were unanimous in their view that many smaller businesses rely on cheques to provide needed payment-related information, a paper trail, and a physical item for record-keeping. Many of these businesses have not found an electronic payment method that they believe can provide the same level of information and utility as cheques do today.

Interview responses also suggest a number of general reasons why AFT payments have grown, and have potential to keep growing. These include lower cost relative to other options (e.g., LVTS payments and credit cards), convenience compared to cheques (from both the origination and receipt perspectives), and a demand from payors and payees wishing to improve payments efficiency. These drivers are expected to continue to push more end-users towards AFT payments, as further opportunities emerge for using AFT.

D. Opportunities for future AFT growth

Several opportunities are identified to further transition portions of cheque use to AFT payments. As expected, the largest potential appears to lie with business payments, where small and medium-sized businesses present a particularly sizeable segment for future AFT growth. Payments made to and from the various levels of government present a further opportunity for AFT payments, since many government payments continue to be made using cheques. Three specific opportunities for AFT growth are discussed in greater detail below.

Standardization and richer remittance information

A long-term opportunity, discussed by nearly every expert interviewed, is allowance for richer and more standardized remittance information to accompany AFT payment messages. This would accommodate automated reconciliation of payment receipts and disbursements with internal receivables and payables for businesses, which in turn can facilitate straight-through-processing. With this in mind, ISO 20022 is an international standard designed to simplify global business communication and enable efficient payment clearing and settlement among financial institutions. The ISO 20022 payment message standard is increasingly being embraced by the global financial community in order to address legacy standard limitations, most notably limitations associated with the amount of information that can travel alongside payment data in the same message.

After extensive member and stakeholder consultation, the CPA launched the ISO 20022 initiative in recognition that payment messaging standards need to evolve to support continued growth in electronic payments in Canada.²⁹ In line with global experience, the CPA's ISO 20022 initiative is a response to the need among Canadian businesses and governments for more remittance

²⁹ For more information visit the CPA's ISO 20022 webpage:
http://www.cdnpay.ca/imis15/eng/Our_Strategy/eng/strategy/ISO_20022.aspx

information to support automated reconciliation and straight-through-processing. ISO 20022 adoption for AFT payments may offer a direct solution to the payments needs of many businesses and governments, and has the potential to impact the use of cheques across Canadian organizations of all sizes.

Getting More Small and Medium-Sized Businesses to Use AFT Credits

While ISO 20022 is expected to address user needs over the long-term, opportunities exist today that may help increase the use of AFT payments over the shorter-term. For example, AFT use by small and medium-sized businesses could be bolstered by the promotion of online banking services and improved education.

The use of online banking has accelerated in recent years, but was still only used by 67 per cent of Canadians in 2012.³⁰ This suggests considerable room for growth of electronic means of payment (for consumers and smaller businesses at least), including AFT payments. Online banking portals and services have boosted the use of AFT transactions, as it has given consumers and businesses the ability to initiate account transfers and payments to businesses. As the use of these online banking services grows and reaches more consumer and business payors, the channel is likely to attract more businesses interested in accepting direct credit payments as payees. It is expected that future AFT credit growth will occur as more businesses embrace online banking services to send payments, and as more of the approximately one million small and medium-sized businesses, that do not accept direct credits are convinced to do so.³¹

Interviewees also revealed a widely-held belief that small and medium-sized businesses could be encouraged to make greater use of AFT payments through improved education and outreach. Some businesses may not fully understand the convenience and efficiency gains associated with using AFT payments (e.g., automation and improved cash management and forecasting) over cheques, which could even apply to small businesses with low payment volumes.

Similarly, privacy and security concerns appear to also discourage small businesses (and some consumers) from using AFT payments. Education may raise awareness and the level of trust with AFT payments, and facilitate better informed choices in payments use.

More Government Payments and Receivables Using AFT

The federal government is moving forward with initiatives to increase the use of direct deposit for payment disbursements, through an electronic invoicing portal and by phasing out cheque payments.³² If more provincial and municipal governments in Canada were to emulate the federal

³⁰ *How Canadians Bank*, CBA, October 2013

³¹ In 2012, only about 70,000 out of 1.1 million businesses were set up to accept direct credits via online banking. This is derived from the number of billers (7,500) operating within the CPA's Corporate Creditor Identification Number (CCIN) framework (http://www.cdnpay.ca/imis15/eng/Clearing_Settlement/Corporate_Creditor_Identification_Number/eng/sys/Corporate_Creditor_Identification_Number.aspx) and our estimate of the number of businesses accepting AFT credits for bill payments (about 60,000). Of note, CCIN billers still account for the vast majority of bill payments used by large corporate billers; however, our research indicates AFT credit acceptance for electronic bill payments is growing faster for smaller businesses.

³² Government of Canada, <http://news.gc.ca/web/article-en.do?nid=667819>, April (2012)

government's cheque reduction initiative, tens of millions of payments, mostly involving businesses, could migrate to the AFT channel.³³ In addition, AFT PADs provide a potential payment alternative to the cheques received by governments. In one example, Revenu Québec has moved large numbers of consumer and business tax payments to be remitted to the province using AFT PADs.³⁴

5. Conclusion

During the past two decades, the use of cheques in Canada has steadily declined. AFT payments have served as an important substitute for cheques as a means of payment in Canada, particularly since 2002.

The long-term growth prospects for AFT payments will depend on the ability of this payment instrument to better meet the needs of all levels of government and small and medium-sized businesses in Canada. These users require enhanced standardization of payment messages which can also carry richer remittance information. Successful conversion by the CPA to the ISO 20022 payment messaging standard for AFT payments has the potential to best meet the needs for enhanced remittance information, and in turn could have the greatest impact in reducing the remaining cheque use in Canada.

In the interim, government payments and receipts will continue to be a source of AFT payments growth, as initiatives progress to reduce the acceptance and disbursement of cheques. AFT payments growth will also continue as more businesses make payments through online banking portals and services, and transition to accepting AFT payments. Misconceptions regarding the relative benefits of cheques over AFT payments could also be addressed in the near-term via improved education and outreach, which might serve to further bolster AFT use.³⁵

Despite these challenges, AFT payments leverage a time-tested system to facilitate many of Canada's most important payment transactions. Many Canadian businesses, consumers and governments have already transitioned to AFT payments use, and are convinced that AFT provides a low-cost and flexible payment vehicle. As such, as the payments industry moves to address the remaining opportunities for electronic payments adoption, AFT payments appear well-positioned to provide a foundation from which future payment products and innovation might be built.

³³ As mentioned in an earlier footnote, we conservatively estimate that the programs, operations, and revenue collections of the lower levels of government result in about 30 million cheque items being exchanged each year.

³⁴ A major financial institution, operating in Quebec, reported that these tax remittances rank as one of the top areas for PAD growth in the province in recent years.

³⁵ Education could address a number of areas where misunderstandings exist, such as in security, fraud mitigation and recourse in the use of direct payments. General information regarding the payment options and case studies of businesses that use electronic payments, might also be useful features of a concerted education initiative.