CFSI Center for Financial Services Innovation
An Affiliate of ShoreBank Corporation

The Industry Forecast for Prepaid Cards, 2009

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Executive Summary[1]

More than one-third of the 40 million underbanked individuals in the United States would rather use a prepaid card than a checking account for basic financial transactions if costs were equal.[2] Underbanked consumers say they appreciate the convenience, transparency, and privacy of prepaid cards. In addition, prepaid cards offer the promise of a checkless checking account, enabling financially underserved individuals not only to conduct transactions conveniently, cheaply, and safely, but also to save and access credit.

To understand current trends in general purpose reloadable (GPR) prepaid cards, CFSI partnered with Paybefore.com to conduct an Internet poll of industry executives. CFSI then interviewed 18 industry leaders across the spectrum of participants in the prepaid value chain. All interviews were conducted with senior level managers, generally the person responsible for the prepaid card business within a large company or the chief executive officer of a smaller company.

The following were among the survey findings.

- 70 percent of industry executives believe that 2009 industry growth will either be the same or higher than 2008.

- 82 percent of prepaid executives consider the underbanked important or very important to future growth.

- 33 percent identify building customer awareness as the biggest challenge facing the prepaid industry, with business model/economics following close behind at 26 percent.

- 65 percent suggest that better education of existing customers is the best way to improve customer awareness, while 61 percent think increased advertising and marketing is necessary.

The strategies pursued by prepaid companies vary greatly, but the research suggests that they fall into two large categories. One approach is to offer the cards as a tool to facilitate transactions—in other words, as another payment product alongside money orders and bill payment. The other is to treat prepaid cards as a substitute for bank accounts by building in features that essentially transform the card into a checkless checking account. These two routes require different card features as well as different marketing and distribution strategies.

[1] Note that the term “prepaid” is used in this paper to refer only to general purpose reloadable prepaid cards unless otherwise specified in the text.
[2] “Underbanked Consumer Study,” Center For Financial Services Innovation, June 2008.

We don't have hard evidence about which approach consumers prefer. The industry lacks the benchmarking data about numbers of active cardholders and patterns of card use that would allow us to quantify consumer demand and prove that either strategy is more effective (for both consumers and industry) than the other. Our hypothesis is that prepaid cards serve different purposes for different consumers. Developing a successful prepaid card program requires segmenting the large, diverse underbanked market and matching the marketing and distribution strategy chosen to the market segment identified. To accomplish this, more research is needed about the financial behavior and attitudes of underbanked individuals, particularly as it relates to prepaid cards.

Industry Update

Since the introduction of prepaid phone cards in the 1970s, the uses of prepaid cards have grown exponentially. Prepaid cards now serve as gift cards, deliver incentives and rebates to consumers and employees, provide healthcare funds through flexible spending accounts and health savings accounts, and even pay salaries. Federal and state governments use prepaid cards to replace checks for unemployment benefits, social security payments, and child support payments.

Prepaid cards branded by a major payment network (American Express, Discover, MasterCard, or Visa), that can be used anywhere that those brands are accepted, and that can be reloaded either electronically or at a merchant location are referred to as general purpose reloadable (GPR) cards. These prepaid cards give underbanked consumers a safe and secure way to make purchases and pay bills. In addition, some GPR prepaid cards open the door to a full suite of financial services, including access to savings accounts, loans, and the opportunity to build a credit history.

Producing a prepaid card requires collaboration by multiple companies. Behind every card is an issuing bank that provides the BIN number for the cards and typically holds the funds accessed by the cards. Processors provide the software and services that drive the transactions from the time the card is swiped until the payment is settled with the bank. These two entities typically come together through a program manager that handles the marketing and day-to-day operations of a card program. Sometimes program managers provide fulfillment and distribution services, but more often they contract with other companies for these services. Issuers and processors also may act as program managers, but often the program manager is a third party. Along with these players, the networks (Visa, MasterCard, Discover, and American Express) provide the electronic channels through which the transactions happen. Finally, reload networks allow cardholders to add funds to their cards by giving cash to a merchant at a point of sale.

No standard industry figures are available about the size or growth rate of the prepaid market, but estimates suggest that the industry is growing rapidly and represents a substantial market opportunity. The Mercator Advisory Group estimates that $4.7 billion was loaded onto network-branded prepaid cards in 2003, and that the amount grew to $38.7 billion in 2007. Aite Group estimates that prepaid transactions totaled $113 billion in 2007. Pelorus Group estimates that purchases made with open-loop prepaid cards would total about $106 billion in 2007.[3] Prepaid still represents a small fraction of card usage. In its most recent study of electronic payments, the Federal Reserve estimated that in 2006, 312.8 million transactions were conducted using open-loop prepaid cards, for a total value of $13.3 billion, versus 25.3 billion debit-card transactions and 19 billion credit-card transactions, with a value of $986.9 billion and $1.9 trillion respectively.

Figure 1: *Prepaid Industry Estimates*

	Aite	Federal Reserve	Mercator	Pelorus
Estimate	$113 billion in transactions in 2007	312.8 million prepaid transactions in 2006, with a total value of $13.3 billion	$38.7 billion loaded onto prepaid cards in 2007	$106 billion in transactions in 2007

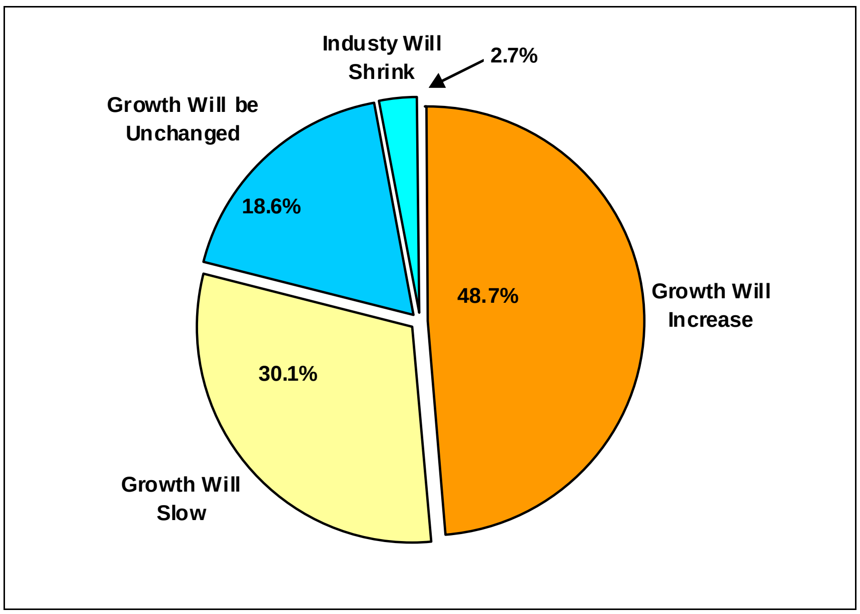
[3] "The Electronic Payments Study," Federal Reserve System, 2007.

Industry Outlook

In conjunction with Paybefore.com, an online publication that covers the prepaid card industry, CFSI surveyed prepaid industry executives about the opportunities and obstacles facing GPR cards. More than 100 industry participants responded to the survey, which was conducted online in November 2008. The responses were voluntary and anonymous, and they are not statistically representative of the industry. However, the survey offers a window into industry sentiment. Following this survey, CFSI interviewed 18 industry executives and observers in depth between December 2008 and February 2009.

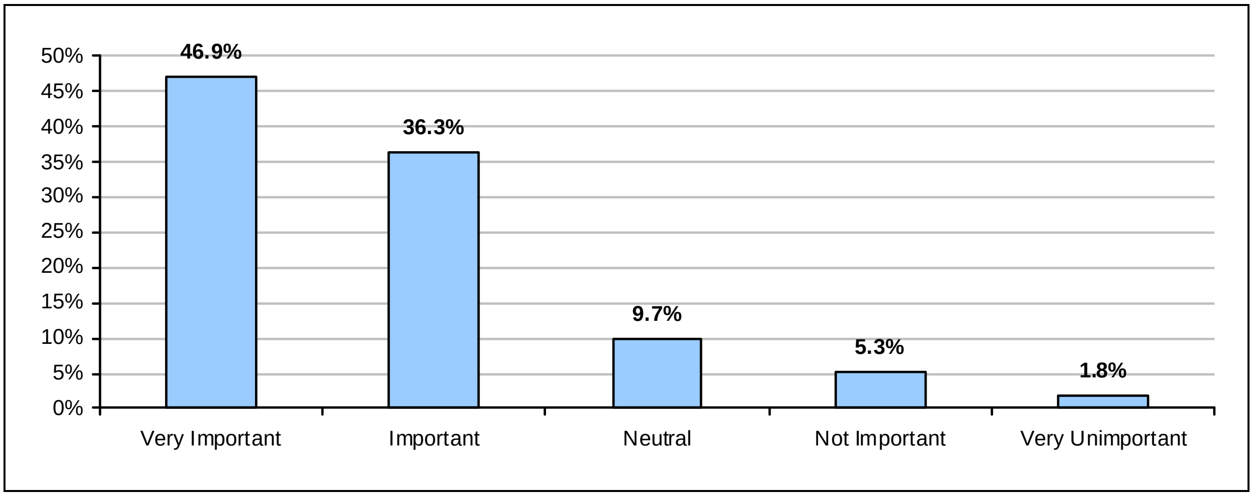
Surprisingly, despite the economic environment, fewer than 3 percent of respondents expect that the GPR industry will shrink in 2009. Almost half expect higher growth in 2009 than in 2008, while 30 percent believe that growth will slow and 19 percent predict it will be unchanged. Economic conditions have worsened since the survey was conducted in late November, but CFSI's industry interviews, which are more recent, generally echoed this optimistic outlook. Executives maintained that the current environment is positive for prepaid because fewer consumers will have access to credit cards and more consumers will have negative experiences with their bank accounts, whether because of overdraft fees or generally poor public sentiment. Both factors increase the relative attractiveness of prepaid as an electronic payment method. In addition, many asserted that the prepaid industry is still young and so far from saturation that there is room for growth regardless of the condition of the economy overall.

***Figure 2:** Industry Growth in 2009 versus 2008*



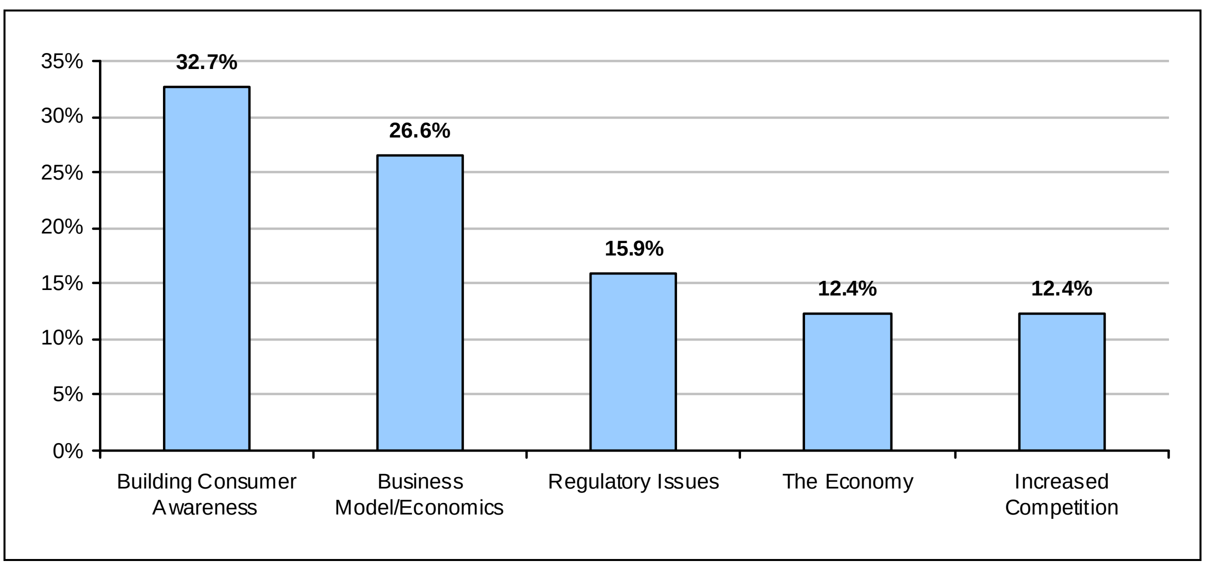
The majority of survey participants and interviewees consider the underbanked extremely important to the future of the GPR prepaid card market. Over 80 percent of survey respondents say that reaching the underbanked market is "very important" or "important" to future growth. This sentiment was repeated in our industry interviews, with many executives reporting that their customers have had either limited or negative experiences with traditional banking products.

***Figure 3:** Importance of Underbanked Consumers to Prepaid Industry Growth*



According to one-third of survey respondents, the biggest challenge faced by the prepaid industry is insufficient customer awareness. Interviewees concurred with this sentiment. Almost universally, they said that consumers do not yet have sufficient general awareness of what prepaid cards offer, how they work, or how GPR prepaid cards differ from gift cards. This places a burden on the customer acquisition process, because companies need to explain the service offering as well as why their version is the best. Several executives suggested the need for a general awareness campaign. A handful blamed the term "prepaid," at least in part, because it may not connote that the cards are reusable and designed as an ongoing financial tool. Ideas to replace the term include "checkless checking" or even going back to "stored value cards."

***Figure 4:** Biggest Challenge for the Prepaid Industry*

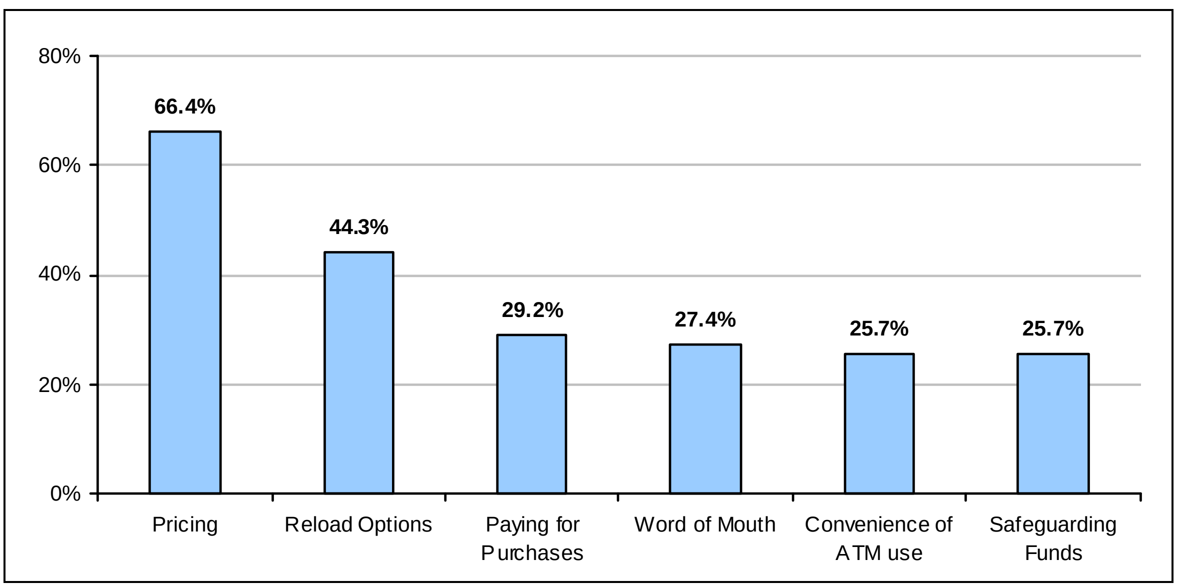


Over a quarter (27 percent) of survey respondents said that business model/economics is the biggest challenge facing the industry. While the prepaid industry is still young, with many start-ups, pressure to produce profits is increasing, particularly in light of today's weak economic performance for many companies. In our interviews, industry executives expanded on this point, with some suggesting that the difficulty of raising capital and pressure from investors seeking an exit strategy will push some companies out of the business. In addition, many predicted both vertical and horizontal industry consolidation. The value chain behind the creation and distribution of prepaid cards is relatively crowded. Each player needs revenue. A more streamlined value chain could make it easier to achieve profitability.

Prepaid Card Benefits, Functionality, and Features

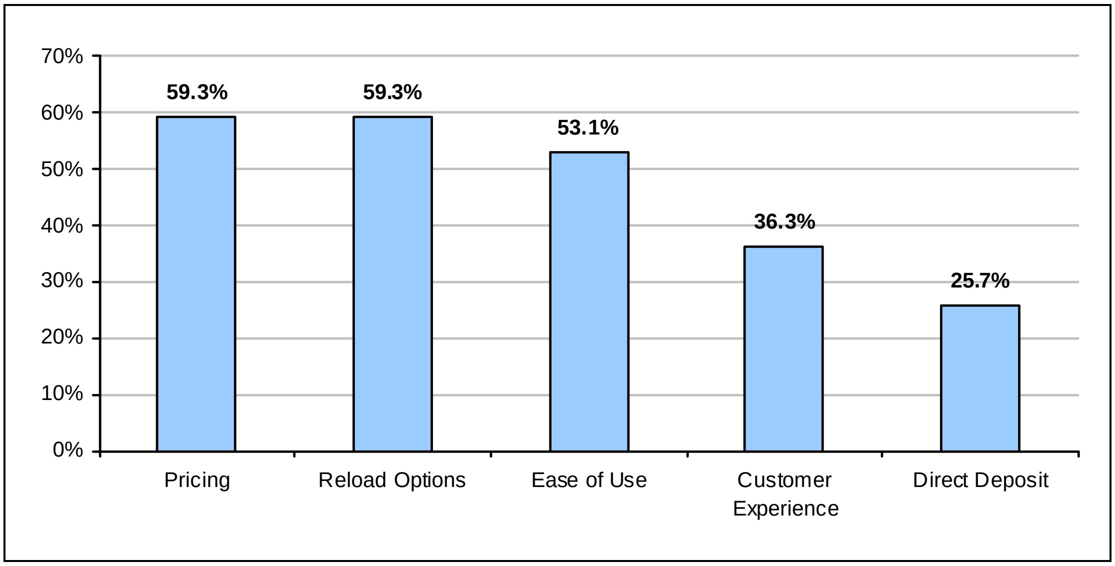
A significant purpose of the research was to identify what card benefits, functionality, and features industry participants see as most important to customer acquisition and retention. In addition, survey and interview participants were asked what features they currently offer and what features they might add within the next 12 months. Pricing and reload options were identified as the most important product variables for both customer acquisition and retention. Survey respondents consider reload options even more important in retaining existing customers than in acquiring new ones. Other important drivers of customer adoption identified in the survey are: the ability to pay for purchases (29 percent), word-of-mouth referrals (27 percent), the convenience of ATM use (26 percent), and the ability to safeguard funds (26 percent). To retain customers, the most important factors cited are: general ease of use (53 percent), the customer experience (36 percent), direct deposit (26 percent), bill pay (13 percent), and credit building (13 percent). Note that respondents could identify more than one choice as important.

Figure 5: *Factors Important to Acquire Customers*



Answers with a response rate greater than 25% shown.

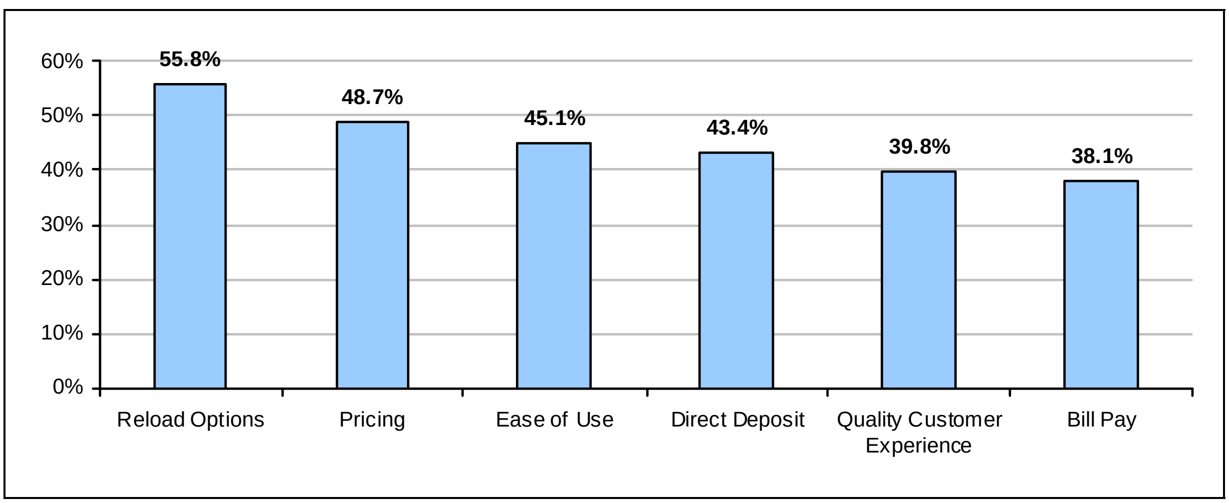
Figure 6: *Factors Important to Retain Customers*



Answers with a response rate greater than 25% shown.

In prior research about prepaid cards, CFSI noted an apparent rush to add as many new features to prepaid cards as possible. Current research suggests this phenomenon has slowed down. The industry is coalescing around certain functionality standards for a prepaid card offering. This standard functionality includes the ability to make purchases at a point of sale (POS), access cash at ATMs and POS terminals, and connect to at least one large reload network. Most also make available and encourage direct deposit, provide a method to pay bills, and offer a means to cost-effectively check account balances in real time, generally through text messaging.

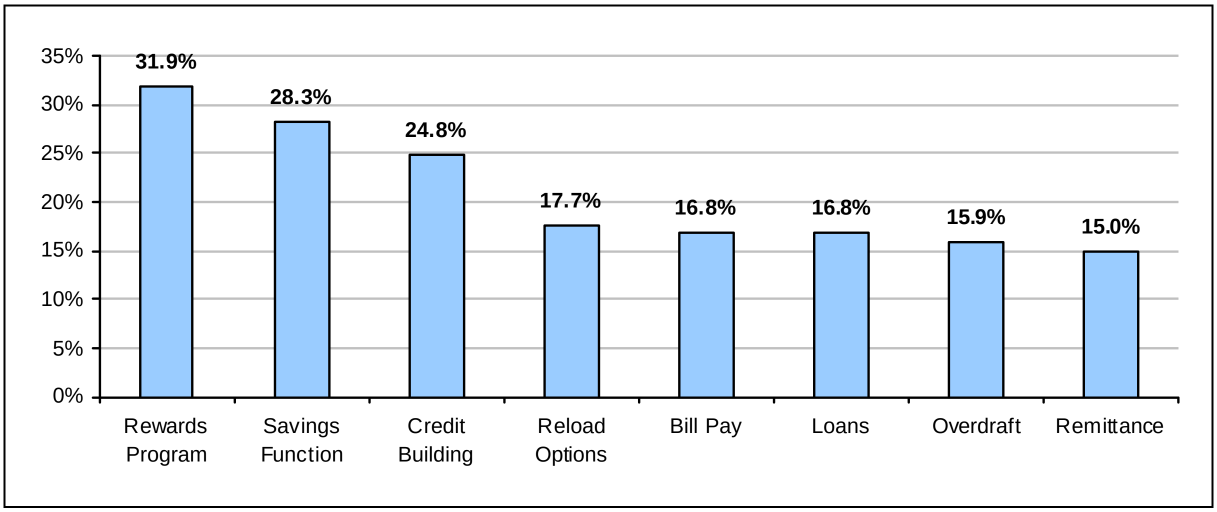
Figure 7: *Features You Currently Offer*



Answers with a response rate greater than 25% shown.

Many industry leaders interviewed suggested that it is counterproductive to incorporate too many additional features, because they add material cost and complexity without being sufficiently valued by the consumer. Having a defined, baseline level of services provided via standard prepaid cards is positive, making it easier for consumers to understand the product category and differentiate among products. This should help with product definition and customer acquisition. However, retention is still a substantial issue, and we don't yet know enough about how various product features influence customer longevity. We are still seeing meaningful innovations in product development as card program managers experiment with ways to increase card use and longevity.

Figure 8: *Features You Are Considering Offering in the Next 12 Months*



Answers with a response rate greater than 15% shown.

The key areas being considered for improvements are as follows:

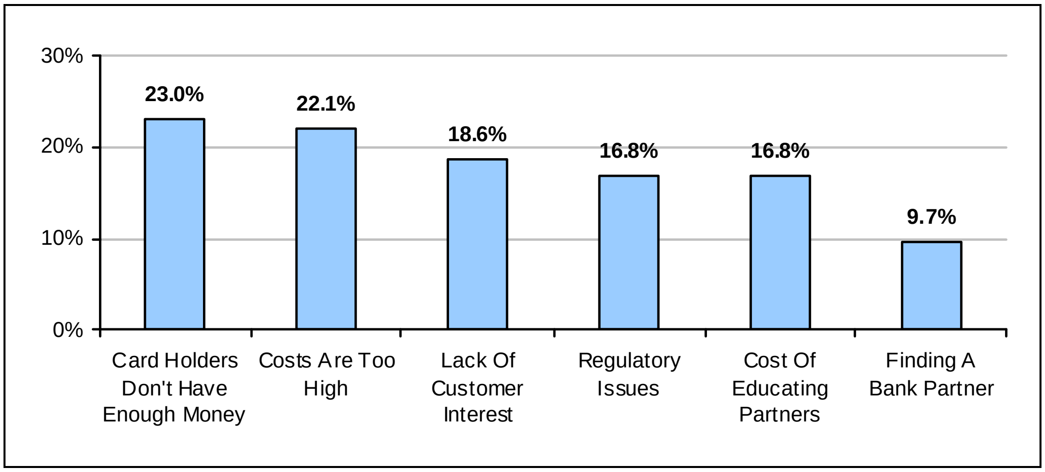
- Direct deposit: Direct deposit correlates closely with high card usage and longer retention, according to almost every industry executive interviewed. Thus, it is important to get more cardholders to use it. Some program managers are offering a financial incentive to do so, generally by waiving monthly or transaction fees. Others can print a document that looks like a cancelled check, which cardholders can give to their employers to make it easier to set up direct deposit. Another promising avenue is pursuing a distribution strategy more likely to bring in consumers who want direct deposit, such as working through employers or online.

- Savings: The best known savings feature in the industry is NetSpend's. NetSpend savings accounts function like online savings accounts, with a 5 percent interest rate currently paid on deposits. In the first eight months of 2008, customers deposited $31 million into the almost 90,000 accounts opened.[4] Both the survey and the interviews reveal skepticism about the utility of including a savings feature as part of standard prepaid cards. This skepticism stems from the idea that while consumers say they want to save, they may not have sufficient income or savings behavior to create meaningful savings balances. However, if prepaid cards are to become true checkless checking accounts, they will need to have a way to distinguish between funds intended for short-term spending and those for longer-

[4] "Americans Make Record Deposits in NetSpend® National Savings Accounts Tied to Prepaid Debit Cards Sold at FISCA Stores," NetSpend Corporation, October 2008 (https://www.netspend.com/info/pr2008-10-15.shtml).

term saving. In addition, consumers seem to use the savings feature of a prepaid card as a budgeting tool, to set aside money for unexpected expenses, rather than to build up significant savings over time.[5] More than 28 percent of survey respondents indicate that their companies are evaluating ways to offer a savings feature. CFSI's research confirms that several industry leaders are developing or getting ready to launch a savings feature.

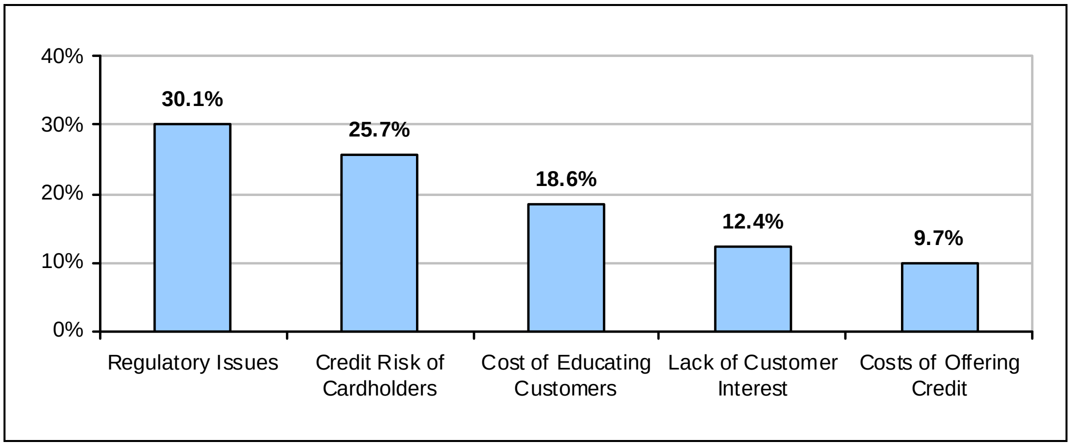
Figure 9: *Challenges to Offering Savings*



- Credit and credit-building: There is positive momentum for including credit-building as a feature of prepaid cards, with more than twice as many survey respondents indicating that they are looking into adding credit-building in the next 12 months than those who offer it currently. Prepaid card companies that partner with the traditional credit bureaus and alternative data collecting and reporting agencies give their consumers the opportunity to create a credit history by using the card. Building a credit history is an important step toward achieving greater financial prosperity, because credit scores are often used to assess applications for credit, insurance, rent, and employment.[6] Meanwhile, several companies are experimenting with offering small-dollar loans as part of their prepaid card. This lending is untested at a large scale and faces several challenges, particularly in today's credit environment. The primary obstacles cited by survey respondents were regulatory issues, credit risk, and the cost of educating customers.

[5] Forthcoming research from the Center for Financial Services Innovation.
[6] For more information, see Rachel Schneider and Arjan Schutte, "The Predictive Value of Alternative Credit Scores," Center for Financial Services Innovation, November 2007.

Figure 10: *Challenges to Offering Credit*



- Reload: With the growth of several nationwide reload networks, geographic proximity to a reload location is no longer a major issue for many potential cardholders. Nonetheless, the reload experience is still not optimal. First, reloading at a point-of-sale location gives consumers the opportunity to switch to another card or payment form, especially if little money remains on a card and a monthly fee is imposed. Second, the reload experience often takes too long, whether because the reload system itself is inefficient or because the clerk using it isn't proficient. Third, there is no uniform reload experience. Interestingly, while respondents in the CFSI/Paybefore survey ranked reload highly among features considered most important to acquire or retain customers, they rated it much lower when asked what they might be adding over the next 12 months. Judging by CFSI's interviews, this reflects the fact that some industry participants—most of the reload networks, for example—think that reload functions perfectly well, while others feel they have no control over the reload experience.

- Customer service: Providing good customer service, particularly to underbanked consumers using a fairly new financial product, can be expensive. Thus, in an effort to keep costs down, many companies have invested in text-messaging services, high-quality call centers, and internet sites. Text messaging is becoming a "must have" for customer service. It is currently the most cost-effective way to provide real-time balance information and transaction confirmation. This information is critical to underbanked consumers, who often budget their expenses down to the penny, pay bills at the last minute, and need to know how much cash they have available in real time. In addition, given that prepaid technology is relatively new, consumers often want verification that their funds have been loaded correctly.

Several other features are clearly on the industry's radar screen, albeit further off. For example, 32 percent of survey respondents report that their companies are considering a rewards program. However, industry research has turned up no evidence that any major company offers a rewards program today.

Overdraft protection may also be more common in the future. If it works like checking account overdraft, it could alienate prepaid cardholders, many of whom choose prepaid cards over checking accounts precisely because the cards won't allow them to spend more than they have.[7] In addition, federal regulatory changes to overdraft are under consideration, and growing national sentiment about the

[7] "Underbanked Consumer Study," Center For Financial Services Innovation, June 2008.

unfairness of bank overdraft charges makes this a treacherous time to contemplate overdraft.[8] Nonetheless, if overdraft is offered as a courtesy for a low or minimal fee, some cardholders might appreciate it.

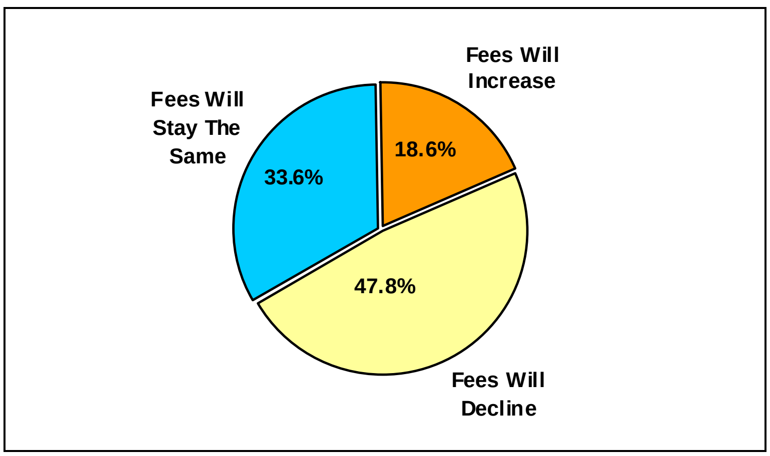
Money transfer services may seem like a logical combination with prepaid cards. Indeed, several prepaid companies and remittance companies have explored the use of prepaid cards for international money transfer.[9] Many such efforts rest on the desire to attract underbanked immigrants to become prepaid cardholders. However, unless the recipient can receive the funds in cash or has easy access to an electronic method of receiving them and then converting them to cash or purchases, these services aren't an appealing replacement for current money transfer options. In addition, to use prepaid cards for money transfer, the sender of funds needs to be persuaded to adopt a prepaid card and a new method of sending funds internationally at the same time.

Finally, financial services innovations that are currently being driven by the mobile communications industry—such as bill payment via cell phone and mobile person-to-person money transfers—sometimes rely on or include a prepaid card used as the account for an unbanked customer. The industry is aware of these products, and they may ultimately converge with other trends in the prepaid industry.

Fees

Almost half (48 percent) of CFSI/Paybefore survey respondents expect fees on prepaid cards to decline over time, with more than half believing fees will either stay the same (34 percent) or increase (19 percent). Industry leaders are similarly divided. Some said that the current fees are necessary to support the product because it is expensive to produce. The value chain has many players, all of whom need to generate revenue. Interviewees also asserted that interchange revenue alone can't support the product because the dollar volume of prepaid transactions is not high enough and interchange fees are declining. Others suggested that fees need to come down to make the product more attractive to consumers, so that more card providers can rely on greater volume to find profitable business models.

Figure 11: *Expectations about Future Pricing*



[8] "FDIC Study of Bank Overdraft Programs," Federal Deposit Insurance Corporation, November 2008.
[9] For more information on remittance technology, see Manuel Orozco, Katy Jacob, and Jennifer Tescher, "Card-Based Remittances: A Closer Look at Supply and Demand," Center For Financial Services Innovation, February 2007.

Reload fees are a major point of contention. Some leaders expressed frustration at the fees, saying they present a major challenge to wider consumer adoption. Others pointed out that reload fees are high because a portion of the revenue generated goes to the retailer or other agent and that is necessary to motivate retailers to distribute the product and perform reload transactions.

In a possible sign of the direction of prepaid card fees, Wal-Mart announced in February that it had lowered the purchase price, monthly fee, and reload fee for its Wal-Mart MoneyCard to $3 each. This may signal that Wal-Mart will exert the same type of pricing pressure on prepaid card fees that it has wielded in retail generally. Wal-Mart has sold over 2 million MoneyCards in less than two years, but whether its market presence and advertising will lead other companies to lower their fees remains to be seen.

Below is a list of the fees charged by many major card programs. Activation fees range from $3 to $29.95, with the majority of the cards charging $9.95. Monthly fees range from zero to $9.95, depending on usage. These fee ranges are much the same as what CFSI found in a similar analysis conducted in 2007, when purchase and activation fees typically ranged between $9.95 and $14.95, and monthly fees were $4.95 to $7.95. One difference is that fees seem more consistent, with two thirds of the cards examined charging $4.95 for card activation. Another major difference is that several providers are now offering significant financial incentives, including waiver of monthly fees, for direct deposit or maintenance of a certain balance.

Figure 12: *Fee Comparison*

	Activation Fee	Monthly Fee	POS Transaction (PIN)	POS Transaction (Signature)
AccountNow Classic	$9.95 ($0 with direct deposit)	$4.95	$1.00	$0
AccountNow Premium	$9.95 ($0 with direct deposit)	$9.95	$0	$0
Bank Freedom	$9.95 ($0 with direct deposit)	$9.95 ($0 with direct deposit of $350+ per month)	$0.95	$0
GreenDot Everyday	$9.95	$4.95	$0	$0
GreenDot Premier	$19.95	$9.95 ($4.95 if you load $750+ per month)	$0	$0
H & R Block Emerald Card	Free (if H&R does your taxes and loads refund)	$2.50 (after 3 months of inactivity)	$0	$0
IDT Sigo (launched by Center for Community Change)	$9.95	$2.95	$0.50	$0
Netspend: Fee Advantage	$9.95	$9.95	$0	$0
Netspend: Pay-As-You-Go	$9.95	$0	$2.00	$1.00

nFinanSe	$5.95	$2.95	$0	$0
Precash Vision Prepaid Card	$29.95 ($0 if direct deposit used 3 times)	$7.80 ($0 if direct deposit continually used)	$0.95	$0
RushCard	$19.95	1.95 inactivity fee	$1.00	$1
Walmart MoneyCard	$3.00	$3.00	$0	$0
Western Union Prepaid Visa	$9.95	$0	$0.99	$0.99
Wired Plastic Prepaid Visa Card	$9.95	3.95	$0.95	$0
Average	$11.22	$4.99	$0.60	$0.21
Median	$9.95	$3.95	$0.73	$0

(Source: CFSI research.)

Marketing and Distribution

While strategies pursued by prepaid companies vary widely, our research suggests that they fall into two large categories. One approach is to offer the cards as a tool to facilitate transactions—in other words, as another payment product alongside money orders and bill payment. The other is to treat prepaid cards as a substitute for bank accounts by building in features that essentially transform the card into a checkless checking account. While these two routes, by definition, imply different card features, the choice of marketing and distribution strategy also affects which strategy may be pursued.

Those providers pursuing a transactional strategy are more likely to sell their cards in retail locations with less hands-on interaction with the card purchaser. Meanwhile, those pursuing a checkless checking strategy are working to condition cardholders to think of prepaid cards as an ongoing financial services tool by selling them at a customer service desk or strongly encouraging direct deposit. This reinforces the idea for the consumer that the prepaid card is more than a gift card to be used once and then thrown away. Loading tax refunds onto a prepaid card is also a critical strategy adopted by several market players to encourage long-term use of prepaid cards. Features such as bill payment, savings, and budgeting tools may also encourage consumers to use their cards longer and more often.

Many industry leaders are looking at ways to increase the longevity and use of prepaid cards once they have been acquired. Though no public data exists, our interviews suggested that the average card lifecycle is six to eight months. For consumers holding the product such a short time, it is difficult to generate profits without high activation and transaction fees.

Figure 13: *Channels that Lead to the Most Loyal, Highest-Use Customers*

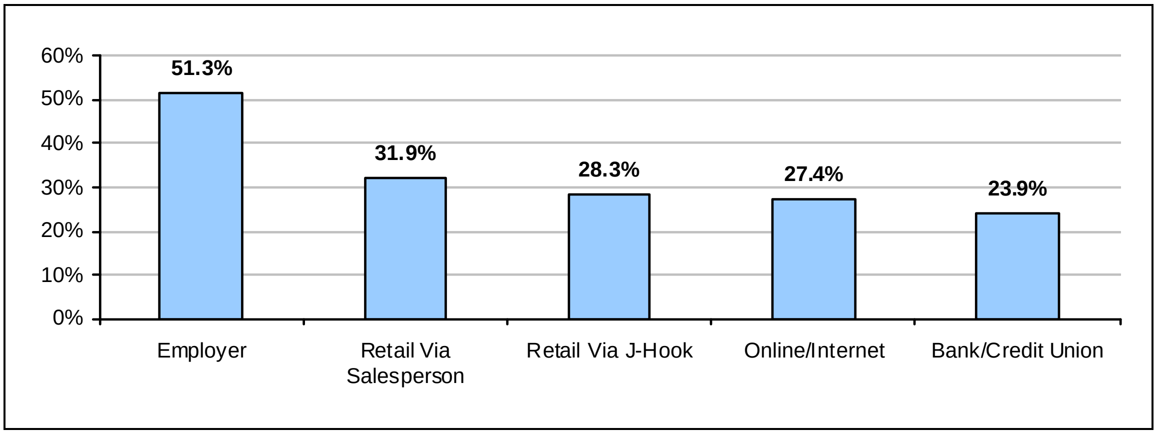
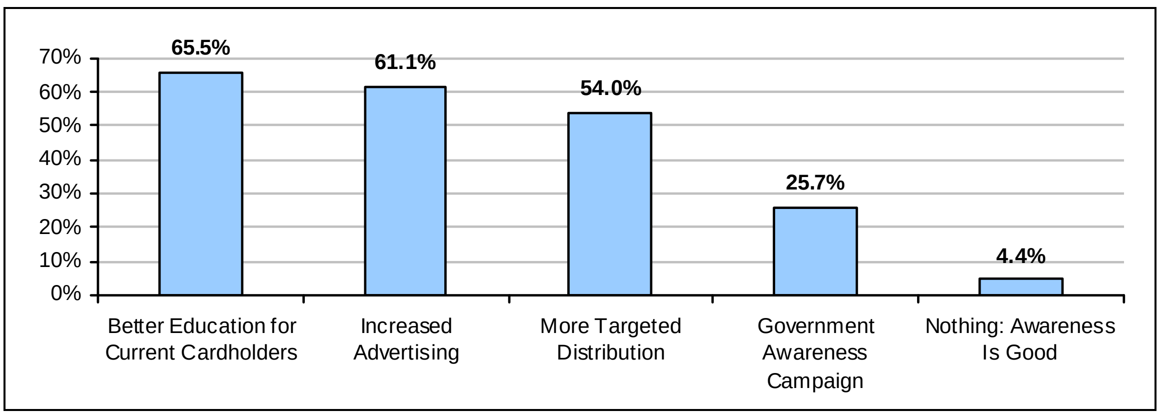


Figure 14: *Best Way to Improve Customer Awareness*



All of our interviews with industry leaders, as well as the CFSI/Paybefore survey, indicate the need to raise consumer awareness. In fact, fewer than 5 percent of survey respondents say that nothing needs to be done to improve customer awareness. Interestingly, almost two-thirds (66 percent) indicate that the best way to increase customer awareness is to better educate existing customers. Some industry participants are working actively on this issue. For example Visa and Wal-Mart have teamed up to offer financial education online to Wal-Mart MoneyCard holders. The other major recommendations to increase consumer awareness are more advertising (61 percent) and more targeted distribution methods (54 percent).

Nonprofits may be one way to reach the underbanked, with both more and better consumer education about prepaid cards and as a distribution point for the cards themselves.[10] Nonprofit organizations often have strong networks, deep credibility, and open communication with their communities. In addition, their knowledge of their customers and existing financial programs (such as financial literacy curricula or free tax preparation) can provide a reasonable basis for a new financial service such as a prepaid card. A

[10] For more information, see Michael J. Herrmann and Rachel Schneider, “Nonprofit Distribution of Prepaid Cards,” Center for Financial Services Innovation, March 2008.

notable experiment in this vein is a partnership between AccountNow and the Center for Community Change to distribute prepaid cards through community organizations known as worker centers.

U.S. Department of Treasury: Direct Express®[11]

For decades, the U.S. Department of the Treasury has been working to transition recipients of government payments, such as social security, from paper checks to direct deposit. The government could realize tremendous savings by doing away with paper checks, since it costs more than $1 to issue a check, while ACH disbursements cost just 10.5 cents each.

However, one problem that surfaced immediately was how to electronically disburse funds to benefits recipients who have no bank account. Over the years, the Treasury Department has tried various solutions, including the Electronic Transfer Account (www.eta-find.gov) and prepaid cards. In fact, the first federal government pilot to provide benefits via prepaid cards was more than 20 years ago, in 1989. In April 2008, the Treasury Department initiated the Direct Express program to develop and market a prepaid card targeted to social security recipients without bank accounts. Called Direct Express, the program has been enormously successful, with over 355,000 enrollees since the card was launched in spring 2008 (through February 2009).

Direct Express offers several valuable lessons for other prepaid programs. First, the card is simple to use and the Treasury provides a great deal of customer education and information. Free messages with balance information are available via phone, email, and text, including free notifications if the balance falls below a level predetermined by the cardholder.

Second, the Social Security Administration modified its benefits application process to make direct deposit the default choice for receiving payments. When an individual applies for benefits, he or she is offered direct deposit to a bank account as the first way to receive funds. If the answer is no, Direct Express is offered. If the answer is still no, the individual can sign up to receive a paper check. Perhaps because it is the default, and because it is simple and convenient, Social Security offices are enrolling 1,000 people daily.

Third, the Treasury has developed strong local partnerships to market its Go Direct campaign, which encourages direct deposit of government benefits generally, including to the Direct Express card. In selected areas, the Treasury developed relationships with local organizations, such as fire departments, police departments, banks, and community centers, to promote direct deposit in their own campaigns. For example, a local police department could include a note about direct deposit in its crime prevention literature.

Finally, the Direct Express card has very low fees. There is no monthly fee; no activation fee; no charge for POS transactions, including cash withdrawal; free balance inquiry; and one free ATM transaction per month. Non-government driven programs cannot necessarily expect to match this pricing. They generally offer additional functionality, particularly the ability to reload funds other than government benefits, and they do not have the government's negotiating power or distribution network. The simplicity of Direct Express's pricing structure, however, is a noteworthy model.

[11] Direct Express® is a service mark of the U.S. Department of the Treasury, Financial Management Service.

Infrastructure

The prepaid industry is still developing its card-processing capabilities. Currently, prepaid processing lacks the deep capabilities of credit card processing, particularly when it comes to reporting, analysis, and campaign management. To better match their offerings to customer demands, program managers would like processors to provide better data and analytical tools. Interviewees said that program managers need to choose either a large processor that can guarantee greater dependability and system stability at the expense of customization, or a more nimble processor that provides more flexibility but less dependability. In either case, it is not possible to cover global operations with one processing system. And, in either case, the program manager is likely to invest in additional in-house processing capabilities to supplement what the processor provides.

Meanwhile, prepaid processors are trying to accommodate an incredible range of products, from gift cards to GPR cards, healthcare-related cards, payroll cards, and others. Each has wildly different features and functionality, distribution methods, and portfolio characteristics. Even within GPR prepaid cards, the variation among cards is extraordinary, with some representing fundamentally different businesses. This puts significant pressure on processors to be all things to all card programs. Given the volume of transactions conducted in GPR prepaid, investing in developing the functionality for true customization is difficult.

While some executives interviewed said that processing capabilities are a major bottleneck to prepaid growth, others were comfortable with the capabilities available today, believing that they will increase as the industry reaches greater scale and maturity. Others argued that current processing systems represent an opportunity to streamline the value chain: if program managers develop their own processing capabilities, one fewer participant will need to generate revenue. Regardless of what side of this debate one takes, it is encouraging that new entrants are tackling the problem.

Regulatory Issues

Regulatory issues are always on the minds of financial services executives. With the federal government contemplating large-scale change to its financial industry regulations, this is certainly justifiable today. And, it probably explains why 16 percent of respondents to the CFSI/Paybefore survey said that regulatory issues are one of the biggest challenges to the growth of the GPR prepaid card industry.

However, industry leaders interviewed overwhelmingly said that the regulatory uncertainty that had initially clouded the GPR prepaid card industry is no longer as pressing of a concern.

First, one of the biggest regulatory issues has been resolved, because the FDIC has confirmed that the funds held in a GPR prepaid card are covered by FDIC insurance. In order for an individual cardholders' funds to be covered, the program manager or issuer must meet certain requirements about managing the funds, including keeping detailed records of the amount of funds in the pooled account allocated to each cardholder. The majority of program managers and issuers are already doing this. The application of FDIC insurance could lead regulators to scrutinize prepaid programs more closely as the cards become more like bank accounts, but the dangers for prepaid programs are likely outweighed by the additional consumer confidence created by FDIC insurance.

Second, while there is still regulatory uncertainty about the application of Anti–Money Laundering laws to prepaid card programs, the industry leaders we spoke with asserted that most card programs today have erred on the side of caution by implementing the same types of safeguards that would be required if the regulatory regime did apply to them. Thus, while the industry would prefer clarity, this is not as pressing a question as it was in the past.

Conclusion

Although there is much we still do not know about what drives prepaid card adoption and retention, what marketing and distribution strategies work best and what features consumers value most, there is no doubt that prepaid cards are becoming increasingly widespread.

The biggest barriers to growth are the lack of consumer awareness and the economics of the current business model. With many players in the value chain each needing a share of the revenue, the industry still must rely on high fees to achieve profitability. The industry needs to generate more widespread adoption of the product, greater card usage and longer cardholder lifecycles.

Nevertheless, the prepaid industry is optimistic. Even in the current economic environment, participants in the prepaid card industry are bullish about the future. Many agreed that while it may be difficult for some companies to raise capital this year, there should be no shortage of customers. The economic downturn is generally expected to expand the target market for prepaid cards, as consumers look for ways to make payments without relying on credit, whether by choice or by necessity. And because the industry is so young, there is room for growth, especially as consumers become increasingly aware of the many potential uses of prepaid cards.

Selected list of companies interviewed for this paper:

AccountNow
Bryan Cave
First United Security Bank
U.S. Department of the Treasury
GE Money
Green Dot
H&R Block
MasterCard
Meta Payment
MoneyGram
NetSpend
PreCash
Ready Credit
Ready Financial
TxVia
Visa

About CFSI:

The Center for Financial Services Innovation, a non-profit affiliate of ShoreBank Corporation, facilitates financial services industry efforts to serve underbanked consumers across the economic, geographic and cultural spectrum. It provides funding and resources, enables partnerships, and identifies, develops and distributes authoritative information on how to respond to the needs of the underbanked profitably and responsibly. CFSI works with banks, credit unions, technology vendors, alternative service providers, consumer advocates and policy makers to forge pioneering relationships, products and strategies that will transform industry practice and the lives of underbanked consumers. For more on CFSI, go to www.cfsinnovation.com.

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