

Written Testimony of

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Subcommittee on Financial Institutions and Consumer Protection**

Examining Issues in the Prepaid Card Market

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Thank you, Chairman Brown, Ranking Member Corker and Members of the Committee. On behalf of the Center for Financial Services Innovation, I appreciate the opportunity to participate as a witness before the Senate Banking Subcommittee on Financial Institutions and Consumer Protection on the matter of prepaid cards. We appreciate the Subcommittee's attention to this important financial innovation.

I am the President & CEO of the Center for Financial Services Innovation. CFSI is a national nonprofit organization, in its eighth year of providing national leadership, research, and insights on the everyday financial services needs of financially underserved consumers. We conduct consumer and industry research to develop a broad understanding of consumers in this segment and the products offered to them. We organize roundtables with large and small financial services providers and nonprofits to develop and advance products and strategies for serving underserved consumers. Each year we bring together over 600 representatives from the financial services sector, including innovators, nonprofits, and policymakers, to spotlight how innovation, partnerships, and public policy can improve financial services for underserved families. We provide grants to nonprofits that are building underserved consumers' financial capability through the marriage of financial education, financial products and technology.

Finally, we develop and champion federal policy to spur financial product innovation and market competition and address impediments to access to high-quality financial services. Our vision is for consumers to have access to an array of high-quality products and services that enable them to safely and effectively transact, save, borrow and plan.

CFSI has studied the general purpose reloadable (GPR) prepaid card¹ market for nearly a decade, publishing our first white paper on the topic in 2004 when the cards were still commonly known as stored value cards. We have published 16 reports since then, detailing industry developments and consumer preferences, behaviors and perceptions. We have been working most recently with researchers at the Payment Cards Center of the Federal Reserve Bank of Philadelphia to analyze prepaid card transaction data to understand how consumers use the product. We also work with non-profit organizations to provide them the information they need to help their clients use prepaid cards safely and effectively; we published the Nonprofit's Guide to Prepaid in 2010. Last summer, we convened the Prepaid Advisory Council, bringing together 19 of the leading companies from across the prepaid supply chain and consumer advocacy organizations to create a forum for dialogue about what makes for a high-quality prepaid card. The group dialogue has informed the creation of a prepaid quality guide, which we expect to publish this summer.

Yesterday, we released our recommendations for a standardized fee box for improving the transparency of prepaid cards, and three prepaid card providers have committed to adopt or test CFSI's proposed disclosure box.

CFSI believes that well designed prepaid cards can offer a critical onramp to the financial mainstream for underserved consumers. My testimony will focus on the financial needs of consumers and how prepaid can meet those needs, and on creating an enabling environment that simultaneously supports high-quality innovation and protects consumers.

What are prepaid cards, and what benefits do they offer consumers?

Over the past decade, an ever-growing array of financial services has become available for people who have traditionally been financially underserved. Previously, the 30 to 40 million American households who were unable to open a bank account or chose not to use one regularly were limited to cash, money orders, and check cashers for their basic banking needs.² But technological innovations have given the underserved more and better options, such as prepaid cards. Prepaid cards were first introduced in the early 1990s and represent a family of products ranging from gift cards to payroll cards to general spending cards. CFSI's

¹ In my testimony, I use "prepaid card" to refer to general purpose reloadable (GPR) prepaid cards. As the description implies, these are cards that can be broadly used (in contrast to, for example, most gift cards or transit cards), can be reloaded by the user, and carry the brand of one of the four major payments networks (Visa, MasterCard, American Express, Discover). The type of card I am referring to is sometimes also called a "prepaid debit card" or a "prepaid card account."

² The FDIC's 2009 National Survey of Unbanked and Underbanked Households estimated that approximately 30 million households were underserved (http://economicinclusion.gov/about_survey.html). CFSI's 2008 Underbanked Consumer Study estimated that approximately 40 million households were either unbanked or underbanked (<http://cfsinnovation.com/publications/list/CFSIUnderbankedConsumerStudy>). The two studies defined underbanked households slightly differently.

work focuses on general purpose reloadable (GPR) prepaid cards, which have the most relevance and utility to the underserved.

Prepaid cards are virtual bank accounts, and they represent a truly new point of financial access at a time when access is diminishing. Prepaid cards function like electronic bank accounts without checks; consumers load funds on the card and, with the majority of prepaid cards, can spend only what they load. And because prepaid cards can be loaded only with funds that are immediately available, they overcome the “check hold” problem that sends those who are living paycheck to paycheck to check cashers rather than banks.³

Anyone can qualify for a prepaid card, regardless of credit history. Many underserved consumers either do not have, or do not perceive themselves as having, a sufficiently positive credit history to access traditional bank accounts. Prepaid cards do not require a credit check, but they do offer many features of conventional cards, including branded Visa or MasterCard logos and near-universal acceptability.

Prepaid cards can be conveniently accessed and used. They are sold in a variety of locations—retailers, bank and credit union branches, online, nonprofit organizations, and more. The cards are accepted nearly everywhere and can be used to pay bills, send money home, make purchases, and save. For cash-based consumers, prepaid cards allow users to make purchases and pay bills without carrying large amounts of cash. They also enable access to web-based commerce.

Prepaid card providers have in recent years begun to add a broad range of features and functions—including bill payment, money transfer, saving, and credit building—that hold promise for linking near-term transactions to longer-term asset building. For instance, at least five prepaid card providers now offer customers high-yield savings accounts linked to their cards.⁴ Combining low-cost transaction services with opportunities for savings and credit access is seen as a “best-practice” model for the financial services industry.⁵

³ Prepaid card providers typically encourage direct deposit of funds and do not charge for it. Research has shown that prepaid card customers using direct deposit load more money, use their card more frequently, and keep their cards active for longer. As a result, many prepaid providers are actively encouraging their customers to use direct deposit. However, an estimated 25% of American workers don’t use direct deposit, either because they lack access to it or choose not to use it. Those without direct deposit must use cash to load their cards, meaning they first need to cash their check and pay a fee for doing so. Some providers, like Walmart, will waive the fee to load a prepaid card if a consumer cashes the check in the store. Nonetheless, this “cash in” issue is an ongoing challenge to prepaid and raises the cost to use the product. Innovations in remote-deposit capture may offer a potential solution.

⁴ These cards include Advance America Visa Prepaid Card, Plastyc UPSide Visa Card, NetSpend Prepaid Debit Card, Mango Money Prepaid Card and PreCash Vision Premier Visa Prepaid Card.

⁵ Caskey, John P. (2005). “Reaching out to the unbanked.” Inclusion in the American Dream. M. Sherraden. New York, Oxford University Press: 149-65.

The promise of prepaid and the value it can provide is particularly important in the wake of the financial crisis. An increasing number of consumers are financially vulnerable due to foreclosure, unemployment and high levels of debt. At the same time, new regulations reigning in overdraft and interchange fees have changed the underlying economics of a basic checking account, leading depositories to restructure and reprice their offerings. The bottom line: underserved consumers face reduced access to checking accounts and other basic financial products.

Consumers need more choices in the market, and prepaid has an important role to play in meeting unmet financial needs. In part driven by the broader trends, the nascent prepaid card industry has grown rapidly, with millions of cards in use today. According to an industry research group, the funds loaded onto GPR prepaid cards in 2008 totaled \$8.7 billion and is projected to rise to over \$118 billion by 2012. The total amount loaded onto all types of prepaid cards is estimated to double over the next three years to \$672 billion in 2013.⁶

What do consumers think of prepaid debit cards?

In 2008, CFSI worked with researchers at the University of Washington to conduct in-depth interviews with approximately two dozen prepaid card users in order to understand why people were choosing to use prepaid cards, how they were using them, and how consumers perceived the product.⁷

With some exceptions, customers in the study had low or moderate incomes and substantial personal debt. Few owned a home. Unpaid utility bills and fees were the most common sources of debt, and credit cards and medical bills the largest debts.

All but one interviewee had used conventional bank-based checking or savings accounts before starting to use prepaid cards, and a majority had opened banking accounts as adolescents. But by the time of the interview, 14 had no conventional bank account. Most had either closed their accounts or had their accounts closed by the banks for reasons that included overdraft fees, unexpected or unanticipated fees, unauthorized account access, and being a victim of identity theft.

Overdraft fees were a common complaint. Some felt their bank chose to honor one big check in order to allow several smaller checks to bounce, each one incurring a costly overdraft fee. Unauthorized transactions (the term was often used interchangeably with identity theft), some of which put their accounts into the red, were another problem mentioned. Some consumers

⁶ Mercator Advisory Group, Seventh Annual Prepaid Card Forecast, http://www.mercatoradvisorygroup.com/index.php?doc=Prepaid&action=view_item&id=519&catid=16.

⁷ Gordon, Sarah E. (2009). "A tool for getting by or getting ahead?" CFSI. http://cfsinnovation.com/system/files/imported/managed_documents/voc-prepaidfinal.pdf.

said they simply could not understand banks' fee structures. Customers did not hold themselves harmless in disputes with banks. One mentioned a gambling addiction; others considered themselves bad money managers. But the way their banks handled or ignored their problems left them mistrustful.

Interviewees saw prepaid cards as a useful tool, a way to escape the high fees imposed by banks and check-cashing companies. All interviewees said they used their cards regularly to pay bills online and over the phone and to make point-of-sale purchases such as groceries and gas. The majority said they loaded funds through direct deposit.

Taken together, the results suggested six elements of the prepaid card experience that customers valued:

Convenience: Cardholders do not have to travel to multiple locations to cash a check, buy money orders, and then deliver payments. The only inconvenience mentioned involved cash reloads.

Accessibility and inclusion: Branded cards (with Visa, MasterCard, Discover, or American Express logos) are accepted almost universally. Moreover, the prepaid cards offer a feeling of inclusion, providing a way to pay that does not differentiate users of prepaid cards from cardholders who have debit or credit cards.

Immediate liquidity: Many low-income consumers use check cashers rather than checking accounts because they cannot afford to wait for a bank to clear a deposited check. Funds directly deposited to a quality prepaid account are available immediately.

Simplicity and transparency: The fee structures of prepaid cards are easy to understand. With few exceptions, prepaid cards charge fees up front for services rendered, as opposed to checking accounts, which charge unexpected penalty fees after the fact. Problems with checking account overdrafts were a primary reason the cardholders interviewed left their checking accounts for prepaid.⁸

Value: Most customers felt the costs associated with prepaid were fair and lower than what they would incur if they used a check casher or checking account.

⁸ For an explanation of why prepaid cards engender trust, and why consumers are willing to pay more for that trust, see: Wolf, Daniel (2012, March 1) "Trying to Understand the Unbanked's Acceptance of Prepaid Cards." *American Banker*. http://www.americanbanker.com/magazine/122_3/trying-to-understand-the-unbankeds-acceptance-of-prepaid-cards-1046840-1.html

Built-in discipline: Customers liked knowing that they could only spend what they had. They also used the cards to limit spending and stay on budget.

About half of the consumers in the sample used a prepaid card with a linked savings account, providing a window into whether more robust card functionality can be useful. All but one consumer had deposited funds into the savings account at some point and four customers had balances ranging from \$97 to \$500 at the time of the interviews. Some customers were using the account to build emergency savings, others to help with monthly budgeting. Those who elected to have funds automatically transferred upon every new load had more success amassing savings.

It is important to acknowledge that not all prepaid products are created equal, and there have been some that have been poorly structured, outrageously priced, and a bad deal for consumers. On balance, however, the accessibility, simplicity, convenience and value that most prepaid cards provide make them a promising product for everyday consumers. To ensure prepaid lives up to that promise, it is critical that we do more to ensure they provide a safe and robust experience.

How can we ensure prepaid card accounts offer a safe and robust experience for consumers?

Increasingly, prepaid cards are being marketed and used by consumers as alternatives to traditional checking accounts. Currently, however, these products are not explicitly required by regulation to have many of the same consumer protections as bank accounts, such as FDIC insurance, fraud and error resolution procedures, and account disclosures. Although most major prepaid card providers already offer all or most of these consumer protections, consumers need to be confident that any prepaid card includes the same strong protections.

The best way to extend these protections to prepaid cards, however, is not simply to replicate the way they have been applied to checking accounts. Although the purpose and function of prepaid cards is similar to those of checking accounts, their structure is fundamentally different. To ensure that prepaid cards can continue to meet the unique needs and demands of the underserved, protections must be thoughtfully applied in a manner that is both suitable for the consumer and feasible for prepaid providers.

CFSI recommends the following extensions of consumer protections to GPR prepaid cards⁹:

1. Mandate FDIC pass-through insurance.

⁹ Newville, D., & Koide, M. (2011). "Prepaid Cards and Consumer Protection." Retrieved from: http://cfsinnovation.com/system/files/CFSI_PrepaidPolicy_July2011.pdf

2. Extend Regulation E as it is applied to payroll cards and enhance the protections by:
 - Lengthening the period for which transaction history is available;
 - Enabling consumers to make a single request for ongoing paper statements; and
 - Studying and leveraging advances in technology and insights in financial capability to improve the delivery of account information.
3. Require a standardized fee-disclosure box and encourage additional disclosure tools for consumers, based on advances in technology and insights in financial capability.¹⁰

While most prepaid companies have taken at least some steps to make it easier for consumers to find and understand the fees associated with their products, an examination of current prepaid fee disclosure practices clearly shows that there is a need for improvement in the industry overall. There tend to be a range of different kinds of fees across card products, and exactly how and where they are disclosed varies widely, making it difficult for consumers to make comparisons before they make a purchase decision.

CFSI has designed a model fee disclosure box based on research on current fee disclosure practices in the prepaid card marketplace, best practices in disclosure for a variety of financial and nonfinancial products, and extensive data on the types of prepaid card fees consumers are currently incurring. Three prepaid card providers – Green Dot, Plastyc, and Ready Credit - have committed to adopt or test CFSI’s proposed disclosure box.¹¹

Ultimately any model fee box adopted by regulators, as CFSI recommends, should be based on robust consumer and industry research, and have both the costs and benefits of the specific aspects of its design carefully measured and weighed. It should also be vetted by and be the product of vigorous discussions among all the major stakeholders in the field, including industry representatives, consumer advocates, nonprofit practitioners, regulators, and researchers. Lastly, any proposed model fee box should be rigorously tested on actual prepaid card consumers to ensure its effectiveness before being implemented.

In conclusion, prepaid cards hold great promise for improving the manner in which tens of millions of American households conduct their financial activities. Like traditional checking accounts, their utility and their cost depends on the terms of the product, the customer’s understanding of the product, and how the customer uses the product. But at a time when traditional financial institutions are changing the pricing structures of their accounts and

¹⁰ Newville, David. (2012). “Thinking Inside the Box: Improving Consumer Outcomes Through Better Fee Disclosure for Prepaid Cards.” CFSI. Retrieved from:

http://cfsinnovation.com/system/files/CFSI_Prepaid%20Cards%20Whitepaper%20Final_0.pdf

¹¹ Center for Financial Services Innovation. (2012). CFSI Proposes a Model Fee Disclosure Box for Prepaid Cards [Press Release]. Retrieved from: <http://cfsinnovation.com/content/cfsi-proposes-model-fee-disclosure-box-prepaid-cards>

apparently losing low-balance customers, it is important to encourage the evolution of a well-designed, easily understood, safe alternative.

Thank you, Chairman Brown, Ranking Member Corker and Members of the Committee. I hope these insights prove useful as you seek to ensure that everyday consumers have access to innovative and safe products that help them live their best financial lives. I look forward to your questions.