Prepaid Cards

Lots of Flavors, Not All Delicious

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Some consumers use prepaid cards like cash—others, in place of a bank account.

On the train to Hogwarts, Harry Potter and his friends often snack on Bertie Bott's Every Flavor Beans. Every mouthful is a surprise. Sometimes the beans are delicious: chocolate, marmalade, toffee. Other flavors are disgusting: tripe, rotten egg, sardine, grass.

Prepaid cards are like that. Sometimes, they are just right for your financial needs. At other times, they can leave a bad taste in your mouth. And as with Every Flavor Beans, the outcome can be a surprise.

Getting a Grip on Prepaid Cards

Some consumers use prepaid cards like cash. (See "How Prepaid Cards Resemble Cash.") Others use them like a bank account. Also called *stored value cards*, prepaid cards have money stored or loaded on them. When a payment is made, value is deducted from the amount on the card. Increasingly, marketers refer to these cards as *prepaid debit*.

When the Consumer Financial Protection Bureau (CFPB) announced in May 2012 that it would look into regulating prepaid cards, it pointed to a need "to ensure that consumers' funds on prepaid cards are safe and that card terms and fees are transparent."[1]

The CFPB rulemaking focuses on general-purpose reloadable cards (GPR). There are other types of prepaid cards, but GPR cards are in the news because some consumers are using them instead of a traditional bank account. Unlike bank accounts, however, these cards lack many standard consumer protections. They may charge small but frequent fees for just about anything a consumer wants to do: putting more money on the card, checking a balance, taking cash off the card, using the card (or not using it) for a certain period of time. The fees add up, and it's hard to keep track of them.

> People with low incomes might be drawn to general purpose reloadable cards because they cannot obtain traditional bank accounts.

GPR cards can be used anywhere that accepts Visa, MasterCard, Discover, or American Express, but they do not extend credit (as does a credit card), and they are not linked to a checking account (as is a debit card). Consumers can put money onto the cards online (from a bank account, debit card, or credit card) or at retail outlets (using cash or other payment instruments). Employers, the federal government, and many state governments can deposit funds directly to prepaid cards. When you use this card to buy groceries or pay a telephone bill, it behaves just like any other plastic. Common brands of GPR cards are the AmEx/Walmart Bluebird card, NetSpend, and GreenDot. (See "The Many Flavors of Prepaid Cards.")

Some prepaid cards have been linked to payday lending. *The Wall Street Journal* recently reported on a $400 loan with so many fees that the loan eventually added up to $1,344.[2] In addition, laws on reloadable cards vary from state to state, so it's difficult for consumers to know their rights. The CFPB's proposed rulemaking would address this state-to-state variation.

One reason prepaid cards have prompted concern about consumer safety is that people with low incomes might be drawn to GPR prepaid cards because they cannot obtain traditional bank accounts or because they want to avoid checking account overdraft fees.

The CFPB is looking at three aspects of the cards:

- Making disclosure of fees and terms standard, so consumers are better able to do comparison shopping.
- Determining whether or not consumer liability should be limited—as it is for credit cards and debit cards—to protect consumers from losses from unauthorized transactions.
- Evaluating the costs and benefits of extra features like small-dollar loans and credit repair to see if consumers benefit from such exotic flavors.

The comment period on the rules closed in July 2012. As of this writing, final rules are expected in 2013.

What Are the Better Choices?

Prepaid cards are still a small part of the payments ecosystem. In the Federal Reserve Bank of Boston 2010 Survey of Consumer Payment Choice, only 14 percent of consumers reported owning such reloadable cards. About 6 percent of consumers had reloaded a card within the past 12 months. Reloaders could be using the prepaid card like a bank account. According to the survey, they reload about once a month, putting a median of $50 on the card.

Roughly 7 percent of consumers were unbanked in 2010, meaning they lacked a checking account at a bank, credit union, brokerage, or investment firm. Among that group, 24 percent had a prepaid card of some type and 16 percent had a reloadable card. Because the group of unbanked consumers is so small, it is difficult to draw conclusions about their use of prepaid cards.

For some consumers, prepaid cards actually can be a good choice. The Pew Charitable Trust recently defined three types of consumers and then followed a hypothetical person from each group through a hypothetical month of spending, comparing a general-purpose reloadable prepaid card to a traditional checking account. For the so-called "inexperienced" consumer, checking account overdraft fees made a prepaid card the cheaper option. People who tend to overdraw their accounts may save money with a GPR prepaid card.

How Prepaid Cards Resemble Cash

DIFFERENCES	SIMILARITIES
• Cash more anonymous; may require less ID	• Easy to lose
• Cash accepted more widely	• Prepaid funds ≈ "cash"
• Prepaid electronic/ flexible	• Earn no interest/returns
• Prepaid used online	• "Envelope budgeting"
• Prepaid is durable	• No credit check

Note: Envelope budgeting is an old-fashioned money-management technique. People sort paycheck cash into different envelopes—rent, savings, groceries, and the like—to keep track of finances.

The Many Flavors of Prepaid Cards

Odds are good that you have a prepaid card in your wallet. In 2010, 38 percent of surveyed consumers owned a prepaid card at some point during the year, according to the Boston Fed's Survey of Consumer Payment Choice. Here are some types of cards you may have:

- Phone card
- Merchant rebate or refund card
- Prepaid card that you use to buy your morning drink at Starbucks or Dunkin' Donuts
- Flexible spending account card for health care or child care
- Rapid transit card
- Government electronic benefits (EBT) card
- Payroll or bonus card from your employer
- Location-specific card for a shopping mall or college campus
- Remittance card for sending money to another country
- General-purpose reloadable prepaid card

The proposed rulemaking from the Consumer Financial Protection Bureau is focused on one specific type of card, general-purpose reloadable prepaid cards.

Otherwise, a checking account is cheaper, Pew found.[3]

In surveys over the past few years, the Consumer Payments Research Center has found that consumers' attitude toward prepaid cards is tepid at best. In the 2010 survey, for example, consumers rated prepaid as:

- Less convenient than credit cards or debit cards
- More difficult to set up than credit or debit cards
- Riskier than credit or debit cards
- More expensive than debit cards (although less expensive than credit cards)

In a reflection of those attitudes, consumers use prepaid cards sparingly. The use of debit and credit cards far exceeds the use of prepaid. According to the Boston Fed survey, just 12 percent of consumers had used a prepaid card in the past year. In contrast, about 70 percent used a debit card.

That could be in part because consumers don't necessarily choose a prepaid card. They may passively receive a gift from a friend or get a prepaid card back for a merchandise return. They may receive a flex spending card or payroll card from an employer. They may receive government benefits on a card. They may be required to purchase the card to use public transit. In such situations, consumer preferences and attitudes are less relevant.

In fact, the 2010 Survey of Consumer Payment choice found that one in 40 U.S. consumers owned a payroll card, and one in 20 reported owning a government-issued prepaid card, such as Direct Express. (Numbers may have increased significantly since 2010.)

Although consumers' tastes can vary, some innovators believe that prepaid cards have potential to help people with low and moderate incomes to take control of their finances and save. As card offerings become more standard and consumers become more familiar with the different flavors, financial educators could have opportunities to use prepaid cards to teach about budgeting and encourage savings. It might be worthwhile to take a bite.

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Endnotes

1 Consumer Financial Protection Bureau, "Consumer Financial Protection Bureau Considers Rules on Prepaid Cards" (news release, May 23, 2012), http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-considers-rules-on-prepaid-cards.

2 Suzanne Kapner, "Prepaid Plastic Is Creeping into Credit," *Wall Street Journal*, September 5, 2013, http://online.wsj.com/article/SB10000872396390443686004577633472358255602.html.

3 "Loaded with Uncertainty: Are Prepaid Cards a Smart Alternative to Checking Accounts?" (report, Pew Charitable Trusts, Washington, DC, September 2012), http://www.pewstates.org/research/reports/loaded-with-uncertainty-85899415043.