

# Consumer Payment Options

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Every day consumers are faced with choices about how to pay for a good or service. Debit cards, credit cards, checks, prepaid cards, cash, and even mobile systems are all options available to consumers making a purchase. And it can matter a lot which option a consumer chooses.

## The Details

To make the best payment decisions, consumers need to know a few details about the options.

### Debit Cards: Signing vs. PIN

PIN (personal identification number) debit transactions are referred to as online debit

transactions. When making such a transaction, the card is confirmed and a PIN is entered. The system checks the available funds in the account and, once authorized for the purchase amount, the transaction completes. Many observers believe that the security of PIN debit transactions is enhanced by having the consumer enter his or her PIN. The additional level of verification can reduce the risk of the transaction being fraudulent. Merchants also like PIN debit transactions because the cost to them is less.

Debit transactions using a signature are processed over the credit card network and do not involve a PIN. The signature debit transaction offers protection to consumers

who are more focused on the possibility of accidentally revealing the PIN while typing it out in front of other people.

### Faster Check Processing

A 2003 federal law generally referred to as Check 21 made it possible for banks to eliminate physical transfer of paper checks. Since Check 21 went into effect, most checks have been converted to images and sent electronically for settlement, thus reducing the amount of time that the money is still in the check writer's account. Most checks clear overnight. Compared with the multiple days that ground transportation takes, the processing is fast. Consum-

ers who choose to write checks must therefore be extra careful that they have enough money in their accounts at the moment of payment. Knowing that a deposit the next day will cover the amount is not sufficient overdraft protection.

### Fraud Reduction

Fraud occurs across all payment types, whether it arises from counterfeit bills, bad checks, or the creation of false bank-account numbers.<sup>1</sup> Credit cards offer robust fraud prevention and detection services for consumers. For example, if a credit card is used to pay for a transaction in a location that is a long distance away from the cardholder's home and if a previous transaction took place within a short amount of time at a different locale, the credit card system may raise a red flag and direct the merchant to call the card company for verification. In addition, the cardholder may be contacted by the issuer to see if there is a problem.

Credit cards rely not only on the account number on the front of the card for authentication, they usually require an additional nonembossed three- or four-digit code located on a separate area of the card. Consumers who use a credit card to make online purchases must typically provide that code. Depending on the type of credit card, the digits are referred to as the card verification value, CVV, CVC, CVV2, or CVC2.

### Cash vs. Cards

It is impossible to use cash for online purchases and often impossible to use it to book travel arrangements in person or to pay a phone bill. Additionally, many airlines have stopped accepting cash for food on flights or for plastic headphones. Aside from cash's purchasing-power limitations, using cash also is likely to result in poor record keeping. Consumers get detailed statements from card companies, but if they want to track every purchase accurately when using cash, they must fill out a ledger or keep a receipt for every transaction. Cash does provide a means to protect privacy, and for some consumers, that attribute may outweigh other considerations.

The downside is, of course, that when cash is lost or stolen, it's gone. There is no way to cancel cash as one cancels a check. There is no way to be reimbursed as if using a card or other electronic payment.

### Prepaid Cards

Prepaid cards offer many benefits to consumers whether or not they have a bank account.

Having a prepaid card allows consumers to load funds into an account and limit spending to the amount of available funds. Prepaid cards prevent consumers from overdrawing the account while offering some of the same functionality as debit cards or credit cards. Some prepaid cards make detailed statements available, a benefit to those who wish to track their spending. Additionally, a prepaid card can be registered in case the individual needs it reissued at some time in the future.

## For those consumers who may still be cautious about using their credit or debit cards for online purchases, prepaid cards could be the best alternative.



Although it might be necessary to pay a reissuance fee, registering makes a prepaid card a better option than cash after a loss or theft.

For those consumers who may still be cautious about using their credit or debit cards for online purchases, prepaid cards could be the best alternative. Because they can be used only up to the available funds on the card, a thief could not use the card to make excessive charges. As with any other product, consumers should always check to see what, if any, fees are associated with the prepaid card.

### Automated Clearing House

The Automated Clearinghouse (ACH) was established in the early 1970s so that people and organizations could make payments that occur routinely. A primary goal was to reduce the number of paper checks in the payments system. Over the past 40 years, the ACH has become the largest payment network in the United States. It uses bank-account information (bank routing and account numbers) to move funds electronically over a secure network. In addition to

enabling consumers to deposit their paychecks directly into accounts, ACH services help them purchase goods online, fund prepaid cards, receive tax refunds, and pay recurring bills such as rent and utilities.

### Mobile Payments

Mobile payments are already available in the United States. Anyone who donated to Haiti after the 2010 earthquake using the text messaging called short message service (SMS) has made a mobile payment. Currently, it is possible to send and receive money using a mobile phone that is linked to an account. Although mobile payments seem new here, there have been several launches of mobile-payment applications in recent years, and use of this payment channel is continually expanding.

Mobile payments are not really that different from other types of payment. Rather than focusing on the novelty, consumers should understand that mobile phones have become access devices. As such, they allow one more way to make payments using existing accounts. There are clear advantages to having all the payment types that are currently in wallets moved to secure housing on mobile phones. The additional passwords, alerts, location-based functions, and enhanced authorization for a payment of using a mobile system can offer more security than other payment types.

### Looking Ahead

Whether a consumer's wallet contains cash, credit cards, debit cards, checks, or prepaid cards, or any combination, it is important to know the differences between the payment options. Depending on the situation, a consumer may choose a different payment type or even introduce an entirely new payment method on the basis of the latest information. Who knows, perhaps in the near future everyone will trade in their leather wallets for mobile wallets.

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### Endnote

<sup>1</sup> A Boston Fed gallery exhibit at the time of publication includes a display of counterfeit money and how to detect it. The exhibit is open to the public. See [http://www.economicadventure.org/exhibits/current\\_exhibit.html](http://www.economicadventure.org/exhibits/current_exhibit.html).

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