No. 13-02
January 2013

WORKING PAPER

THE ECONOMICS AND REGULATION OF NETWORK BRANDED PREPAID CARDS

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MERCATUS CENTER
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Abstract

General-purpose reloadable prepaid cards have been one of the fastest-growing sectors of the consumer payments marketplace in recent years. Their importance has accelerated as a consequence of new regulations enacted in the wake of the 2008 financial crisis. This increased use of prepaid cards has also increased angst among regulators, especially regarding the number and size of fees on prepaid cards. State and federal regulators as well as Congress are interested in imposing new regulations on prepaid cards. These calls for regulation, however, have proceeded in a largely fact-free environment. This paper describes the current economic and regulatory landscape for prepaid cards. The market appears to be robustly competitive, as recent years have seen declining costs and increasing functionality as well as entry of major players such as American Express and several large banks. Nor is there any evidence that consumers systematically err in the cards that they choose. Absent a demonstrable competitive market failure or systematic consumer abuse, prescriptive regulation of the terms and substance of prepaid cards would likely have unintended consequences that would exceed the benefits to consumers. On the other hand, there are some regulations that might be enacted that could promote competition and consumer welfare in this rapidly evolving market.

JEL codes

D10, D14, D18, G28

The Economics and Regulation of Network Branded Prepaid Cards

Todd J. Zywicki[1]

General-purpose network branded prepaid cards are one of the fastest growing segments of the consumer banking sector. While retail banking operations have shrunk in response to the financial crisis that began in 2008 and the recession and regulatory responses that followed, the market for prepaid cards has grown rapidly, in large part to fill the niche opened up by the retrenchment of the traditional retail banking sector. Moreover, although prepaid cards traditionally catered to low-income consumers, there has been a rapid mainstreaming of prepaid card usage, as reflected by the entry of retail financial stalwarts such as American Express, J.P. Morgan Chase, U.S. Bancorp, and BB&T.[2] Prepaid cards are rapidly being recognized as a mainstream consumer payment system, along with debit and credit cards.[3]

This paper will examine the economics and government regulation of network branded general-purpose reloadable prepaid (GPR) cards. Network branded prepaid cards are those processed by major payment network brands such as Visa, MasterCard, Discover, and American Express, and accepted wherever those network brands are accepted, just like a debit or credit card. As such, network branded prepaid cards offer many of the same benefits as debit and credit cards: nearly ubiquitous acceptance, convenience, and the ability to make electronic payments easily, including online payments. Fundamentally, the products differ only in the time at which

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[1] George Mason University Foundation Professor of Law; Senior Scholar, Mercatus Center at George Mason University; Editor, *Supreme Court Economic Review*. Financial support was provided by the Mercatus Center and the George Mason Law and Economics Center. I'd like to thank Jerry Ellig and two anonymous referees who reviewed this paper for the Mercatus Center for helpful comments and Cooper Green for research assistance.

[2] Gary Fields & Maya Jackson-Randall, *More People Shun the Bank*, WALL. ST. J., Sept. 12, 2012, at A1.

[3] A fourth font for payments is mobile banking. Although nascent at the time of writing this article, it seems likely that mobile banking will grow in popularity over time, providing a simplified low-cost platform for combining electronic payment capabilities with some traditional banking services. *See* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, CONSUMERS AND MOBILE FINANCIAL SERVICES (Mar. 2012).

the consumer actually pays: as the name suggests, consumers load money onto a prepaid card before using it, whereas debit cards draw money at the time of use, and credit cards allow consumers to pay theirs bill after use. In appearance, prepaid cards are identical to debit and credit cards. Many consumers value this feature, especially lower-income consumers who often feel excluded from the financial mainstream. In essence, prepaid cards provide consumers with the same security, functionality, convenience, and mainstream respectability as those products.

Prepaid cards are especially important for unbanked Americans as a mechanism for electronic payments and as an alternative to traditional bank accounts. Moreover, the number of unbanked consumers has increased in recent years. A 2011 survey by the Federal Deposit Insurance Corporation (FDIC) found that there were approximately 10 million unbanked households in the United States (approximately 8.2 percent of all households),[4] an increase from 9 million unbanked households (7.7 percent of all households) in 2009.[5] Javelin Strategy and Research found that the percentage of consumers without a checking account increased by 50 percent (from 8 percent to 12 percent of the population) from 2010 to 2011.[6] In addition, the FDIC found that approximately 24 million households (20.1 percent of U.S. households) were underbanked in 2011,[7] an increase from 21 million households (17.9 percent) in 2009.[8] Rates of

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[4] Federal Deposit Insurance Corporation, 2011 FDIC National Survey of Unbanked and Underbanked Households (September 2012), http://www.fdic.gov/householdsurvey/ (last updated Sept. 12, 2012).

[5] Federal Deposit Insurance Corporation, 2009 FDIC National Survey of Unbanked and Underbanked Households (December 2009), http://www.fdic.gov/householdsurvey/2009/index.html (last updated Sept. 7, 2012). The Federal Reserve's 2008 Survey of Consumer Payment Choice reported that 6 percent of those in the study did not have bank accounts. *See* Scott Schuh & Joanna Stavins, *How Consumers Pay: Adoption and Use of Payments* 4 (Federal Reserve Bank of Boston Consumer Payments Research Center, Working Paper No. 12-2, 2011).

[6] Javelin Strategy & Research, *Prepaid Cards and Products in 2012: Enabling Financial Access for Underbanked and Gen Y Consumers* 9 (April 2012). The percentage of consumers with a personal savings account also fell from 72 percent to 62 percent of the population. *Id.* at 8 fig.1.

[7] 2011 FDIC National Survey of Unbanked and Underbanked Households, *supra* note 4.

[8] 2009 FDIC National Survey of Unbanked and Underbanked Households, *supra* note 5. The FDIC survey defines an underbanked consumer as one who has a checking or savings account but also uses alternative financial services such as money orders, check cashers, payday lenders, rent-to-own stores, pawn shops, or tax refund anticipation loans. *Id.*

unbanked or underbanked households are especially high among non-Asian minorities, lower-income households, younger households, and unemployed households.[9]

The growth in the number of unbanked and underbanked consumers reflects in part the retrenchment of the retail banking industry in the wake of the financial crisis. But it is also the unintended consequence of several regulatory initiatives that have increased the cost of bank accounts to consumers and reduced access to debit and credit cards. Price controls on debit card interchange fees enacted as part of the Dodd-Frank Financial Reform legislation and new regulatory limits on overdraft protection have dramatically cut into banks' bottom lines leading banks to impose fees and limits on once-free checking accounts. They have also tightened eligibility for free checking through methods such as raising the mandatory minimum balance or tying free checking to usage of other bank products such as mortgages or car loans. According to a fall 2012 Bankrate.com study, only 39 percent of bank accounts were eligible for free checking,[10] down from 45 percent in 2011, and down by almost half from 76 percent in 2009.[11] Similarly, a summer 2012 survey by MoneyRates.com found that the percentage of accounts with free checking had fallen to 35.3 percent, down from 38.8 percent a year earlier, and that in 2012, only 21 percent of the accounts at large banks (those with more than $25 billion in assets) were still free.[12] Meanwhile, Bankrate.com's 2012 survey found that the average monthly service charge on a non-interest-bearing checking account increased 25 percent from 2011, to $5.48 per

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[9] 2011 FDIC National Survey of Unbanked and Underbanked Households, *supra* note 4, at 5.

[10] Claes Bell, *Checking Fees Rise to Record Highs*, BANKRATE.COM (Sept. 24, 2012), http://www.bankrate.com/finance/checking/checking-fees-record-highs-in-2012.aspx#slide=1.

[11] Claes Bell, *Abracadabra: Free Checking Disappears!*, BANKRATE.COM (Sept. 26, 2001), http://www.bankrate.com/finance/checking/abracadabra-free-checking-disappears.aspx. Fees for ATM withdrawals, overdrafts, and other bank fees have risen as well. *See* Claes Bell, *ATM Fees March Upward in 2011*, BANKRATE.COM (Sept. 26, 2011), http://www.bankrate.com/finance/checking/atm-fees-march-upward-in-2011.aspx; Claes Bell, *Consumers Socked with Higher Overdraft Fees*, BANKRATE.COM (Sept. 26, 2011), http://www.bankrate.com/finance/checking/consumers-socked-with-higher-overdraft-fees.aspx.

[12] *See* Richard Barrington, *The Latest MoneyRates.com Update on Bank Fees*, MONEYRATES.COM (Aug. 13, 2012), http://www.money-rates.com/research-center/bank-fees/.

month, and that the average minimum balance needed to avoid a monthly service fee rose by 23 percent, to $723.02 (with some accounts requiring an average minimum balance as high as $5,000).[13]

In addition to raising fees, banks have reduced costs by reducing services (such as by closing bank branches and laying off workers[14]) and by shedding unprofitable customers. For example, Bank of America's CEO has stated that the bank is going to focus on the top 20 percent of most profitable customers and get rid of the unprofitable ones.[15] J.P. Morgan Chase has estimated that new regulations on overdraft programs and price controls on debit card interchange fees have made unprofitable 70 percent of customers with less than $100,000 in deposits, requiring it to raise fees, reduce costs and services, or shed unprofitable customers.[16] At the same time that access to banks has shrunk, credit cards have become less available to many consumers as a result of the Credit CARD Act of 2009, which imposed new rules that directly restricted access to credit cards for consumers under the age of 21 and indirectly restricted access for many lower-income consumers.

Prepaid cards have also become more mainstream for middle-class families. Closed loop prepaid cards, such as gift or reloadable cards that can be used only at a single merchant (such as Target, Starbucks, or Amazon.com) or with a group of related merchants (such as Old Navy, Gap, and Banana Republic), have become a staple of middle-class shopping habits. General-

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[13] Bell, *Checking Fees Rise*, *supra* note 10. The report notes that 56 percent of banks offer fee waivers for signing up for direct deposit, so there remain ways to preserve free checking for many. The required minimum balance for interest-bearing checking was $6,117.80. *Id.*

[14] *See* Press Release, *IBC Announces Branch Closings in Response to New Banking Regulation, Stresses Commitment to Customer Service and Free Products Program* (Sept. 22, 2011), https://www.ibc.com/en-us/Newsroom/Pages/IBCAnnouncesBranchClosingsinResponsetoNewBankingRegulations,StressesCommitmenttoCustomerServiceandFreeProductsProgram.aspx; Susanna Kim, *Bank of America's Cost-Cutting Plans a Reflection of Banking Industry's Woes* (Sept. 23, 2012), http://abcnews.go.com/Business/bank-americas-cost-cutting-reflects-banking-industrys-woes/story?id=17292528#.UGS9B41lTYg (noting plans by Bank of America to fire 16,000 employees and close approximately 378 branches).

[15] Claes Bell, *Prepaid Debit: Oasis for Unbanked?*, BANKRATE.COM (Jan 11, 2012), http://www.bankrate.com/financing/banking/prepaid-debit-oasis-for-unbanked/.

[16] *See* Dan Fitzpatrick & David Enrich, *Big Bank Weights Fee Revamp*, WALL ST. J., Mar. 1, 2012, at p. A1.

purpose "open loop" prepaid cards are becoming more common as well. For example, some parents now provide their college-bound children with prepaid cards to access funds and make electronic payments without the danger of incurring credit card debt. Parents can conveniently reload the cards online and even monitor their children's spending and budgeting habits.[17] Prepaid cards also may be useful for caregivers, such a child's nanny or elderly parent's home care provider. Rather than providing cash and making them account for it after usage, or providing access to a credit or debit card and creating a risk of misuse, prepaid cards enable the caregiver to access funds with greater security and accountability.

As usage of prepaid cards has grown, so has regulatory scrutiny. In large part this scrutiny has focused on the fee structure of prepaid cards, which some critics complain is "unfair." Yet, there is no evidence that prepaid cards are excessively expensive compared to relevant alternatives or that prepaid card customers systematically fail to understand the fees and other costs of prepaid cards or the costs of relevant alternatives. Nor is there any other evidence of a competitive market failure (such as monopoly power) that would support intrusive government regulation at the current time. Instead, the market appears to be robustly competitive with minimal barriers to entry and several major entrants as the market has grown. The largest barrier to competition—regulation itself, namely, the Durbin Amendment—has hampered entry by large financial institutions with truly competitive products. Available evidence, although limited, suggests that prepaid card customers largely understand the costs of prepaid cards as well as relevant alternatives—such as low-balance bank accounts, check cashers, and money orders—and choose among them rationally. Indeed, one source of the growth in prepaid cards'

[17] In fact, prepaid card issuers have developed special prepaid card products aimed at parents of college students that have parental controls built in. *See* Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, at 27 (describing prepaid card products marketed to parents that have parental control features and lower monthly and service fees). As noted, the Credit CARD Act of 2009 also restricted access to credit cards by college-aged students.

popularity is the transparency and comprehensibility of their fees relative to those of bank accounts and credit cards. In addition, it appears that consumers generally act rationally in how they use their cards and in the plans they select, such as in deciding between monthly fee plans on one hand and per-transaction fee plans on the other. Indeed, even as the cost of bank accounts has risen, the cost of prepaid cards has fallen substantially, attesting to the competitiveness of the market.

The analysis and conclusions presented here are tentative and subject to revision. The prepaid card market is growing and evolving rapidly and has experienced substantial changes in entry, innovation, and customer demographics in recent years. Moreover, there has been little academic study of the market. The studies discussed here are of varying degrees of scientific validity and rigor. Many have been funded or written either by industry or consumer activist organizations and thus may be subject to bias. This paper tries to parse through these various studies, to assess their credibility, and to draw a coherent picture of the market today and make predictions about where it is headed.

This paper begins by describing how prepaid cards work and how the industry is structured in comparison to debit and credit cards. Part II describes the regulatory framework for prepaid cards. Part III examines who uses prepaid cards and why. Part IV considers the arguments for regulatory intervention in the market. Part V provides concluding thoughts.

I. Prepaid Cards: Industry Growth, Structure, and Pricing

This section discusses the recent growth in the prepaid card industry and explains how prepaid cards are structured and priced.

A. Prepaid Card Industry Growth

Prepaid cards come in many different forms. They may serve a one-time use or establish long-term relationships, remain anonymous or imprint consumer names, hold pre-denominated or fixed amounts, or retain a loaded value as requested by the consumer.[18] More generally, prepaid cards are distinguished as "closed loop" or "open loop" cards. Closed loop cards include store cards that can be used only at that merchant or a group of affiliated merchants. Open loop cards include payroll cards and general-purpose cards that can be used anywhere the network brand is accepted, just like a credit or debit card.[19]

Although prepaid cards today account for only a small percentage of all payments, recent studies indicate a growing consumer adoption rate for reloadable prepaid cards.[20] According to information provided by the Consumer Financial Protection Bureau, the 2011 transaction volume was $2.141 trillion for credit cards, $2.053 trillion for debit cards, and $57 billion for prepaid cards.[21] Between 2006 and 2009, however, prepaid cards were the fastest-growing segment of noncash payments, growing 21.5 percent per year in volume and 22.9 percent in number of charges. In comparison, debit card annual growth in volume was 14.8 percent and credit card volume actually declined 0.2 percent.[22] Meanwhile, the year-to-year annual percentage growth of dollars loaded on prepaid cards has risen 40 percent or more every year since 2008.[23] Although use of prepaid cards declined slightly from 2008 to 2009, use of debit and credit cards declined

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[18] Cleef et al., *Emerging Trends in Stored Value and Prepaid Cards*, BRYAN CAVE 3 (Dec. 9, 2005), http://www.mtraweb.org/amc/archives/presentations/2005/vancleef-mtra-emerging_trends_v3.pdf.

[19] *Id.*at 4.

[20] Bretton Woods, Inc., *Analysis of Reloadable Prepaid Cards in an Environment of Rising Consumer Banking Fees*, 15 (Mar. 2011), http://bretton-woods.com/media/51f57d9869e66aa1ffff8159ffffd502.pdf.

[21] Consumer Financial Protection Bureau, What's the Deal with Prepaid Cards?, http://www.consumerfinance.gov/notice-and-comment/whats-the-deal-with-prepaid-cards/.

[22] Federal Reserve Bank Services, 2010 Federal Reserve Payments Study, Noncash Payment Trends in the United States: 2006 – 2009 (April 5, 2011), http://www.frbservices.org/files/communications/pdf/research/2010_payments_study.pdf.

[23] *Id.*

more dramatically. Prepaid card transactions actually increased as a percentage of electronic transactions during that period.[24] Since 2009, prepaid card usage has grown dramatically. It is estimated that by 2014 the total annual volume loaded onto general-purpose reloadable prepaid cards will reach $167 billion, up from just $12 billion in 2007.[25]

According to Javelin Strategy and Research, from 2010 to 2011, debit card ownership fell 12 percentage points (from 78 percent to 66 percent of consumers), credit card ownership fell 7 percentage points (from 74 percent to 67 percent), checking account ownership dropped 4 percentage points (from 92 percent to 88 percent), and personal savings account ownership fell 10 percentage points (from 72 percent to 62 percent of consumers). Javelin found that the only major consumer financial product to grow in ownership during that period was prepaid cards, which rose from being used by 11 percent to 13 percent of consumers.[26] This substitution reflects both the growing attractiveness and reduced cost of prepaid cards and the increased cost and reduced availability of debit and credit cards in response to regulation enacted in recent years.

As prepaid card usage has grown, its user base has broadened as well.[27] According to a study by the Payment Cards Center of the Philadelphia Federal Reserve, consumer usage of prepaid cards generally follows a "U-shaped" pattern of distribution, as many consumers use GPR cards infrequently and for only a short amount of time before discarding them, and others use prepaid cards heavily and repeatedly, apparently as a substitute for a traditional checking account.[28] On average a card is active for six months before it is discarded, but this metric shows

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[24] *See* Kevin Foster, Erik Meijer, Scott Schuh & Michael A. Zabek, *The 2009 Survey of Consumer Payment Choice* (Fed. Res. Bank of Boston, Public Policy Discussion Paper No. 11-1, Apr. 2011).
[25] *See* Consumer Financial Protection Bureau, Advance Notice of Proposed Rulemaking, 12 CFR Part 1005, Docket No. CFPB-2012-0019 (citing report by Mercator Advisory Group).
[26] Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, at 8 fig.1.
[27] Bell, *supra* note 15.
[28] *See* Stephanie M. Wilshusen, Robert M. Hunt, James van Opstal, & Rachel Schneider, *Consumers' Use of Prepaid Cards: A Transaction-Based Analysis*, FED. RES. BANK OF PHILADELPHIA PAYMENT CARDS DISCUSSION PAPER 20 (Aug. 2012).

variation by retail channel.[29] Cards purchased at retail outlets typically are active for only two months, payroll cards are active for four months, and GPR cards marketed through a website or a financial institution remain active for about six months.[30] Most cards distributed through retailers are used for five or fewer purchases, and only 11 percent are used more than fifty times, while those marketed through web distributors are used more heavily. According to the Philadelphia Federal Reserve study, more than a quarter of GPR cards are used for fifty or more purchase transactions.[31] Purchase volumes are similarly varied by distribution channel, as 37 percent of cards distributed through the Internet have purchase volumes of more than $1,000 compared to less than 20 percent of those distributed through retailers.[32] Those acquiring cards via the Internet typically reload the cards many more times than those who acquire them from retailers.

Prepaid cards typically can be used to make purchases either with a signature or personal identification number (PIN) as well as to withdraw cash at ATMs or get cash back with purchases at grocery stores and drug stores. Consumers can check their balances online, over the phone, or at an ATM.[33] Prepaid cards also generally offer deposit insurance and fraud protection if certain procedures are followed.[34] In addition, cardholders can use prepaid cards to pay bills online, to remit funds to foreign countries, to get cash back with purchases at grocery stores and drug stores, and to acquire courtesy checks. Some cards also enable the consumer to use the card like a savings account—even offering interest rates higher than prevailing bank rates.[35] Some

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[29] *Id.* at 18.
[30] *Id.* at 19.
[31] *Id.*
[32] *Id.* at 21.
[33] Checking one's balance online via text message or via automated phone service is usually free, but doing so by live operator or through an ATM usually incurs a fee.
[34] There is some uncertainty, however, as to how extensive and uniform these protections are. *See* discussion *infra* at notes 199–204 and accompanying text.
[35] For example, NetSpend has developed a program that allows consumers to have a linked interest-bearing savings account and to transfer funds from the savings account to the card to make payments. *See* Sarah Gordon, Jennifer Romich & Eric Waithaka, *A Tool for Getting by or Getting Ahead? Consumers' Views on Prepaid Cards* (Center for

prepaid card customers express a desire for more cards that will offer savings, direct deposit, and credit building features.[36] On the other hand, others actually prefer prepaid cards over credit cards or debit cards because of their anonymity, because they are not integrated into a credit reporting system, and because they can be obtained without an in-depth identification or credit check.[37]

Overall, prepaid card users appear to be satisfied with the product. According to a National Urban League survey focused on African American consumers, 67 percent of current reloadable prepaid card owners rate their perception of the cards as either positive or very positive overall, and only 7 percent have a negative opinion.[38] Even among former users of prepaid cards who no longer use them, only 15 percent had a negative opinion. Research by the Aite Group also found very high levels of satisfaction with prepaid cards: 73 percent of those surveyed responded that they were "very" or "extremely" satisfied.[39]

B. Industry Structure: How Prepaid Cards Work

The prepaid card network operates similarly to other types of electronic payments systems but with a few differences.[40] The backbone of the system is the card payment network (Visa, MasterCard, Discover, and American Express), which processes the transactions. Like debit and credit cards, prepaid cards also have an issuing bank, which holds the funds stored on

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Financial Services Innovation, 2009). News reports indicate that this savings feature is popular with NetSpend's customers. *See* Fields & Jackson-Randall, *supra* note 2.

[36] *See* PEW HEALTH GROUP, KEY FOCUS GROUP FINDINGS ON PREPAID DEBIT CARDS 3 (Nov. 2011), http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/FSP_12014%20Pew%20DebitCards_R10A-4-5-12.pdf.

[37] *Id.*

[38] *See* Linkage Research & Consulting, Inc., *African American Consumers & Reloadable Prepaid Cards* (Nov. 10, 2011), http://www.nbpca.com/~/media/8E2D5FBB74A04A95A943FF6D4730B69A.ashx. As discussed below, this relative satisfaction with prepaid cards may also reflect a high level of dissatisfaction with alternatives.

[39] Aite Group, *GPR Cardholders: Who Are They Really? Dispelling the Myths* (March 2012), http://www.nbpca.org/~/media/E6E6F720492F4E42804FED2A795D3B5A.ashx.

[40] *See* Center for Financial Services Innovation, *The Nonprofit's Guide to Prepaid Cards*, 17 (Sept. 2010), http://cfsinnovation.com/system/files/CFSI%20Nonprofit%20Guide%20to%20Prepaid.pdf.

the cards. Because many prepaid card users do not have traditional bank accounts, industry members have devised alternative mechanisms to distribute their cards to the public. Certain companies facilitate fulfillment and shipment of the cards, process transactions, and track and distribute funds held in the issuing financial institution.[41] The "program manager" provides the retail interface for the card and handles the marketing and day-to-day operations of the card program.[42] "Loading networks" are outlets located in retail stores where cardholders can acquire a card and add value initially or later by giving cash to a merchant.[43]

Cards themselves are distributed at the retail level by distributors and marketers, such as ACE Cash Express, Walgreens, CVS, Walmart, Kroger, Safeway, gas stations, and Western Union, which act as agents for the loading networks and provide locations where the cards can be loaded or reloaded. NetSpend, one of the largest networks, has over 100,000 loading locations in retail stores.[44] Cards can also be acquired, loaded, and reloaded directly online. According to Javelin Strategy & Research, 48 percent of prepaid card users reload online, more than any other way.[45] Check cashers, such as ACE Cash Express, which traditionally were competitors to prepaid cards, increasingly have become outlets for the retail distribution of reloadable prepaid cards. Some prepaid card companies, such as NetSpend and Green Dot, are partially vertically integrated and provide several different functions in the value and distribution chain, such as program manager, distributor, and reloading network.

Because of the large number of players involved in the distribution and operation of prepaid cards, prepaid cards have a more complicated supply chain than debit and credit cards.

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[41] These include companies such as FIS, FirstData, MT&L, and FSV Payment Systems.
[42] These include companies such as Account Now, Green Dot, NetSpend, and RushCard.
[43] "Loading networks" include brands such as such as Green Dot, Western Union, MoneyGram, Visa ReadyLink, and MasterCard rePower.
[44] About NetSpend, https://www.netspend.com/about_netspend/.
[45] Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, at 29 fig.14. 44 percent reported reloading at a merchant or retailer, 27 percent at a money services provider, 23 percent at a bank branch, and 17 percent at an ATM. *Id.*

The large number of players in the system and the important role played by nonfinancial institutions raises greater insolvency and security risks for prepaid cards than for other types of payment cards. For example, the system of reloading cards at tens of thousands of nonfinancial retailers such as convenience stores and drug stores raises special problems of security, fraud, and misuse.[46]

Prepaid cards generate several different revenue streams, including retail fees, card fees, and interchange fees, but those revenue streams are divided up among many different actors. The links in the prepaid card value chain are generally low-margin businesses in which revenue is generated by a very large number of customers who generate multiple small fees. Moreover, the revenue generated for the industry must be shared among the many parties along the supply chain. The fixed costs of setting up systems and contractual relationships are relatively high and the average ownership duration of a given card is only six months, approximately 5 to 15 percent of the average length of a checking account.[47] Thus, the fixed costs must be recouped in a relatively short time frame. Also, the revenues generated from any customer are relatively low when compared to debit cards or credit cards. Wilshusen et al. estimate that the typical prepaid card generates at most $12 per month in revenue.[48] One reason for low revenues is that customers tend to be relatively young and lower-income, generating a lower volume and dollar amount of transactions than debit or credit card users.

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[46] *See* Philip Keitel, *Insolvency Risk in the Network-Branded Prepaid-Card Value Chain* (Fed. Res. Bank of Philadelphia, Discussion Paper, Sept. 2011), http://www.philadelphiafed.org/consumer-credit-and-payments/payment-cards-center/publications/discussion-papers/2011/D-2011-September-NBPCA-Keitel.pdf.
[47] *Id.* at 18.
[48] Wilshusen, et al., *supra* note 28, at 5.

C. Prepaid Card Fees

The most common criticism of prepaid cards has been about the fees that they charge, including fees for issuance, activation, reloading, ATM usage, and customer service to talk to a live person.[49] A study by Pew Charitable Trusts of 52 prepaid card programs in 2011 found that most cards have seven to fifteen fees to consider and that disclosure of fees was not uniform.[50] But many criticisms of prepaid card fees are overstated or outdated. In practice, very few cards impose all possible fees. Instead, different cards offer different mixes of fees designed to appeal to different types of customers. For example, a particular card might charge a higher monthly fee than its competitors but not charge any fees for speaking to a customer service representative or for providing a paper statement.

Moreover, the size of fees has been declining over time as a result of competition and consumer choice. *Consumer Reports* found in a recent survey that although activation fees used to be standard, today only about half of the sixteen most popular cards charged an activation fee. In addition, Pew's study found, for example, that when fees are charged, they mostly are small, being less than $3 (except for activation and monthly fees, when charged) and frequently $1 or less.[51] Moreover, some large card issuers that used to charge activation fees, including NetSpend and Western Union, no longer do so.[52] Those that continue to charge activation fees (such as the RushCard) have substantially lowered them.[53] AccountNow actually pays a rebate to those who

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[49] *See*, *e.g.*, Consumer Reports, *Prepaid Cards: Loaded with Fees, Weak on Protections* (Mar. 2012), http://www.consumersunion.org/pdf/Prepaid_Cards_Report_2012.pdf.

[50] PEW CHARITABLE TRUSTS, LOADED WITH UNCERTAINTY: ARE PREPAID CARDS A SMART ALTERNATIVE TO CHECKING ACCOUNTS? (Sept. 2012), http://www.pew.org/uploadedFiles/wwwpewtrustsorg/Reports/Prepaid_Cards/Pew_prepaid_checking_report.pdf.

[51] *Id.* For example, although nine card programs charge a fee of $1 or $1.25 when a POS transaction is declined (depending on whether it is signature or PIN debit that is declined), 43 do not. *Id.* at 3.

[52] *See* Consumer Reports, *supra* note 49, at 5.

[53] *Id.*

activate direct deposit on their cards.[54] The Bluebird prepaid card, co-branded between American Express and Walmart, which was introduced in October 2012, has no annual fee, monthly fee, or activation fee.[55]

The most common fee is a monthly maintenance fee, although those fees have been falling over time. Thirteen of sixteen cards surveyed by *Consumer Reports* charge monthly fees ranging from $2.95 to $9.95, although six of the thirteen cards that charge a monthly fee will waive the monthly fee or charge a lower monthly fee if the cardholder direct deposits a certain minimum amount each month, loads a specified amount each month, or makes a certain minimum number of transactions per month. Some cards provide consumers with the option of paying a monthly fee (with free transactions) or instead electing a per-transaction fee without a monthly fee. Most of the cards examined by *Consumer Reports* charged no point-of-sale (POS) transaction fees. Very few cards charge overdraft fees, primarily because few allow overdrafts, but some cards allow cardholders to nominally overdraft to their accounts in some circumstances without charging any fee for doing so.[56]

Other than monthly fees, the amount of fees paid is substantially under the consumer's control and is related to how the card is used, especially ATM use frequency, the frequency and amount of reloading money, and the use of direct deposit.[57] Pew found that fifty-one of the fifty-two cards it examined allowed consumers to avoid loading fees by using direct deposit, and that to avoid ATM fees to acquire cash, consumers can opt for cash back when making a POS PIN

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[54] *Id.*
[55] *See* Robin Sidel and Andrew R. Johnson, *Prepaid Enters Mainstream*, WALL ST. J. at p. C1 (Oct. 9, 2012).
[56] According to the Pew study, 65 percent of cards disclosed that overdraft was not allowed and a fee would not be allowed. Only 10 percent explicitly stated that there was a fee for overdrawing and the median fee was $15. *See* PEW, LOADED, *supra* note 50, at 21.
[57] Card Hub, *Prepaid Cards Report—2011*, http://www.cardhub.com/edu/prepaid-cards-report-2011/ (last visited Feb. 12, 2012).

purchase.[58] In addition, most cards permit customers to view their account balances and some form of transaction history online for free, but most cards charge for obtaining a paper statement.[59]

Wilshusen et al. found that the distribution of fees varies according to the distribution channel through which a consumer obtains a card, which as noted, seems to be a proxy for whether the consumer uses the prepaid card for a short-term purpose (acquired through a retailer) or as more of a long-term bank substitute (acquired through the Internet). As a result, the distribution of fees varies according to the card plan chosen by the consumer and the manner of use. They find that for GPR cards obtained through the Internet, fees such as maintenance and origination fees comprise about 52 percent of the fees charged, ATM withdrawal fees comprise 22 percent, and transaction and other fees (such as those for POS transactions, balance inquiries, obtaining a paper statement, or calling customer service) are 26 percent.[60] For retail GPR cards, by contrast, maintenance and origination fees comprise only 28 percent of fees, ATM withdrawal fees are 17 percent, and the majority of fees (55 percent) are for transactions and other fees.[61] These differing fee distributions are consistent with the suggested pattern of use by consumers of GPR cards for differing purposes.[62] Moreover, although ATM fees are an important component of cardholder cost, the average fee charged (ranging from $1.50 to $2.25) is consistent with the typical foreign ATM fee ($1.65) charged for debit card transactions in 2010.[63]

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[58] PEW, LOADED, *supra* note 50, at 9.
[59] *Id.*
[60] Wilshusen, et al., *supra* note 28, at 31–32, 60 fig.5.2.
[61] *Id.* at 32–33, 61 fig.5.3.
[62] Payroll cards exhibit still different patterns of fee activity: over half (54 percent) of the fees generated by payroll cards are for ATM withdrawals and just 10 percent are maintenance fees. *Id.* at 31–32 and p. 59 fig.5.1.
[63] *Id.* at 32. Pew similarly found an average ATM fee of $2.25. PEW, LOADED, *supra* note 50. The Bankrate.com 2012 study found that the average ATM fee for out-of-network transactions was $2.50 to the owner of the ATM and $1.57 to your own bank. *See* Bell, *Checking Fees Rise*, *supra* note 10.

Fees have been falling in response to competitive pressures and falling costs as the market has grown and scale economies have evolved. According to the Federal Reserve's Survey of Consumer Payment Choice, from 2008 to 2009, the percentage of consumers that rated prepaid cards as "low cost" or "very low cost" rose from 36 percent in 2008 to 45.6 percent in 2009.[64] This increase in the perceived affordability of prepaid cards while bank accounts were becoming more expensive may explain why prepaid card usage rose relative to debit card usage during that time.[65] According to NetSpend's public reports, the percentage of customers electing to use direct deposit is growing as well, rising from 34 percent in 2010 to 41 percent in 2011. This increase signals a greater use of the cards like a bank account and means that more consumers are taking advantage of the lower costs of cards featuring direct deposit.[66]

Growing economies of scale and increasing consumer familiarity and competition should continue to produce declining costs over time. For example, Green Dot is purchasing a small bank in Utah to decrease the service fees its pays to third parties, particularly the third-party bank that issues Green Dot cards.[67] Entry by large banks may lower costs as well. For example, J. P. Morgan Chase's Liquid card charges a flat fee of $4.95 per month with no other fees (other than foreign ATM fees) and provides free customer service, free access to Chase's ATM network, and free reloading through Chase's branches, ATMs, or remote deposits by cellphone.[68]

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[64] Foster, et al., *supra* note 24, at 5.
[65] *Id.* at 30–31.
[66] Press Release, NetSpend Holdings, Inc., NetSpend Holdings, Inc. Reports Fourth Quarter Financial Results (Feb. 16, 2012), http://investor.netspend.com/releasedetail.cfm?releaseid=649475.
[67] *Green Dot Buying Small Utah Bank*, BLOOMBERG BUSINESSWEEK, Nov. 23, 2011, http://www.businessweek.com/ap/financialnews/D9R6MI0G0.htm.
[68] *See* Cardhub.com, Chase Liquid Prepaid Card, http://www.cardhub.com/d/liquid-prepaid-card-684c/.

II. Regulatory Framework

As prepaid cards have grown in usage, regulatory scrutiny has grown as well, both at the state and federal levels. Legislators animated by the sense that the fees charged for various prepaid card services are "unfair" or "excessive" have imposed new regulations on prepaid card terms and disclosures in the name of safety and soundness or consumer protection.

A. Direct Regulation of Prepaid Cards

At the federal level, certain prepaid cards are regulated by the Electronic Fund Transfer Act (EFTA) and the implementing regulation, Regulation E. For example, the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (CARD Act) amended the EFTA by adding new disclosure requirements regarding fees for store gift cards and general-use prepaid cards that are issued for personal and family use and by limiting the circumstances under which a card may have an expiration date.[69] Acting under Regulation E, the Federal Reserve Board has also imposed disclosure requirements on prepaid payroll and government benefit cards but not general-purpose prepaid cards.

State governments also regulate prepaid cards, particularly their sale and administration, including placing limits on expiration dates and fees, disclosures, and cash redemption of unused card balances. California law, for example, prohibits gift cards from expiring, limits dormancy fees, and requires that the cards be redeemable in cash.[70] Further legislation is under consideration in several states now as well.[71] Under the federal EFTA, these state laws are

[69] 12 C.F.R. §1005.20(a).
[70] *See* Cal. Civ. Code §1749.5.
[71] Including New Jersey, *see* CreditKarma.com, *Prepaid Debit Cards, Fees and Impending Regulations*, CREDITKARMA.COM (June 22, 2101), http://blog.creditkarma.com/banking/prepaid-debit-cards-fees-and-impending-regulations/; Illinois, *see* ILLINOIS GENERAL ASSEMBLY Bill H.B. 4451 (Mar. 9, 2012), http://www.ilga.gov/legislation/fulltext.asp?DocName=&SessionId=84&GA=97&DocTypeId=HB&DocNum=4451&GAID=11&LegID=&SpecSess=&Session=; and Puerto Rico, *see* Paybefore.com, *Puerto Rico Legislature Passes*

preserved so long as they are not inconsistent with the EFTA and are considered to be more protective of consumers than federal law.

Congress is also considering new legislation to regulate prepaid cards. Legislation introduced by Senator Robert Menendez (D–N.J.) would impose new substantive and disclosure requirements on prepaid card products.[72] The legislation would, among other provisions, require "pass-through" coverage to consumers of FDIC deposit insurance for prepaid card accounts.[73] More controversially, the legislation would prohibit fees for a large number of card issuer services. The legislation would, for example, prohibit the imposition of any "per transaction" fee for POS usage or for in-network ATM usage. In addition, no fee could be imposed for balance inquiries, customer service inquiries, dormancy, account closing, or overdrafts. Reload fees would be permitted only if the financial institution provides "a reasonable alternate method for adding value" without a fee. The overall effect of the legislation would have a dramatic effect on the market and consumers: it essentially would ban cards priced on a per-transaction basis, forcing all cards to adopt a one-size-fits-all model of a flat monthly fee for "all you can eat" free usage. Such legislation would have the negative effect of harming those consumers who use their cards lightly and for specific reasons and who, as a result, prefer cards priced on a per-transaction basis.[74] The bill would also require the Consumer Financial Protection Bureau

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Fee Restrictions for Prepaid, Industry Urged to Contact Gov. Immediately, PAYBEFORE.COM (Aug. 16, 2012), http://www.paybefore.com/aboutus/default.aspx?id=25438.

[72] *See* The Prepaid Card Consumer Protection Act of 2011, S. 2030 (113th Cong., 1st Sess.), introduced Dec. 17, 2011, http://thomas.loc.gove/cgi-bin/query/z?c112:S.2030:.

[73] Unlike funds held in standard bank accounts, prepaid cards do not provide automatic insurance for an individual's funds loaded onto a prepaid card because the prepaid card program manager actually pools all of its customers' funds in a single account. Nevertheless, the FDIC has established procedures that the bank can follow in order to provide "pass-through" insurance in the name of the individual cardholder, not the program manager that owns the pooled account. In fact, it appears that every card program backed by a federally insured depository institution provides pass-through deposit insurance to the individual cardholder. *See* discussion *infra* at notes 195–200 and accompanying text.

[74] *See infra* notes 191–192 and accompanying text (noting that consumers overwhelmingly choose correctly between the two different card pricing schemes).

(CFPB) to issue a new rule providing a standardized disclosure format for prepaid card fees and prices.

Additionally, the CFPB will have authority to regulate the offering and provision of "consumer financial products," including prepaid cards, and to issue any rules that the CFPB determines to be "necessary or appropriate" to carry out the objectives of federal consumer financial protection laws.[75] With respect to prepaid cards, the CFPB has inherited the Federal Reserve's authority under Regulation E to regulate prepaid cards. In addition, the CFPB has the responsibility to monitor developments in the prepaid market to determine whether to propose additional consumer protections.

Pursuant to this authority, the CFPB has issued an Announcement of Proposed Rulemaking and held a field hearing on the regulation of prepaid cards.[76] The CFPB's announcement asks for comments on a variety of issues, including the degree to which Regulation E should be extended to cover general-purpose prepaid cards, how to regulate prepaid cards in order to promote competition and consumer choice, and whether to mandate special disclosures if a card does not offer pass-through of FDIC insurance. In addition, the CFPB asks for comments on various features of prepaid cards, such as overdraft protection, savings accounts, and the ability to build one's credit by reporting bill payments using prepaid cards to credit reporting agencies.

New regulations imposed on bank overdraft fees beginning in 2009 are indirectly relevant to understanding the market for prepaid cards. By limiting overdraft fees, those regulations reduced access to free checking and thereby increased the number of unbanked consumers. According to Evans, Litan, and Schmalensee, "within days" of the Fed's announcement of its

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[75] *See* Section 1002(15)(A)(v) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1958 (July 21, 2010).
[76] Consumer Financial Protection Bureau, Notice of Proposed Rulemaking, *supra* note 25.

new rules, banks starting scaling back access to free checking, imposing new fees, and eliminating services for consumers.[77] The number of accounts eligible for free checking fell 11percentage points—from 76 percent in 2009 to 65 percent in 2010—a figure that translates to approximately twenty million accounts.[78] The combination of price controls on debit card interchange fees and limits on access to overdraft protection has dramatically reduced access to free checking and swelled the ranks of the unbanked, increasing demand for prepaid cards.

B. The Durbin Amendment

Recent regulations imposed on debit cards and credit cards have also indirectly promoted substitution to prepaid cards. The Durbin Amendment to the Dodd-Frank financial reform legislation places price controls on debit card interchange fees, requiring them to be "reasonable and proportional" to the card issuer's marginal cost.[79] Effective October 1, 2011, "reasonable and proportional" fees are not to exceed the sum of 21 cents and "5 basis points multiplied by the value of the transaction."[80] This cut in the interchange fee rate is estimated to cost banks over $6 billion in revenue annually, and it has prompted banks try to make up for the loss by levying new fees on checking accounts, raising minimum balance requirements, terminating debit card rewards programs, charging higher out-of-network ATM fees, providing incentives to use credit and prepaid cards, and driving away customers that are no longer profitable.[81] An estimated 5

[77] David S. Evans, Robert E. Litan & Richard Schmalensee, *Economic Analysis of the Effects of the Federal Reserve Board's Proposed Debit Card Interchange Fee Regulations on Consumers and Small Businesses* 40 (Feb. 22, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1769887&rec=1&srcabs=1843628.
[78] *Id.*
[79] 15 USCA § 1693o-2(a)(2).
[80] 12 CFR 235.3(b).
[81] Tim Chen, *What the Durbin Amendment Means for You*, U.S. NEWS (2011), http://money.usnews.com/money/blogs/my-money/2011/07/12/what-the-durbin-amendment-means-for-you. For example, many debit card issuers subject to the price controls have eliminated rewards on debit cards while preserving them for credit and prepaid cards. About half of prepaid card users have said that the availability of rewards on prepaid cards would increase the likelihood that they would use them. *See* Javelin Strategy & Research,

percent of consumers eventually will be pushed out of the mainstream banking system by new and higher fees,[82] increasing the number of unbanked consumers by 1 million.[83] The adverse impact of the Durbin Amendment will likely be largest for younger, less educated, and lower-income consumers, and especially those with lower credit scores who will find bank accounts to be more expensive, less available, and of lower quality (such as fewer services, fewer branches, and shorter and less convenient banking hours and locations).[84] Some banks now offer prepaid cards to consumers who are rejected when applying for a checking account because they don't qualify in the current economic and regulatory environment.[85] Even if merchants pass on the savings from decreased debit interchange fees to consumers, low-income consumers who struggle to meet minimum balance requirements or who have poor credit will likely switch to prepaid cards to avoid these new fees.[86]

The average interchange fee on prepaid cards is approximately 40 cents per transaction.[87] Interchange fees are an important revenue source for prepaid cards: during the first quarter of 2011, interchange revenue comprised 32 percent of operating revenue at Green Dot and 24 percent at NetSpend.[88] Wilshusen et al. find that interchange fees comprise about 20 percent of issuer revenue for GPR cards and about half of revenue for payroll cards.[89] Increased marketing

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Javelin Study Finds Prepaid Cards Lure Underbanked and Gen Y Customers (Wed. Apr. 11, 2012), http://finance.yahoo.com/news/javelin-study-finds-prepaid-cards-164300454.html.

[82] Bretton Woods, Inc., *Analysis of Reloadable Prepaid Cards in an Environment of Rising Consumer Banking Fees*, *supra* note 20, at 14.

[83] Evans, et al., *supra* note 77.

[84] *See* Fumiko Hayashi & Joanna Stavins, *Effects of Credit Scores on Consumer Payment Choice* (Fed. Res. Bank of Boston Public Policy Discussion Paper No. 12-1, Feb. 3, 2012).

[85] Elizabeth Ody, *Prepaid Card Use Up 18% as Consumers Drop Debit: Study*, BUSINESSWEEK (Apr. 11, 2012), http://www.businessweek.com/news/2012-04-11/prepaid-card-use-up-18-percent-as-consumers-drop-debit-study.

[86] Tim Chen, *What the Durbin Amendment Means for You*, U.S. NEWS (2011), http://money.usnews.com/money/blogs/my-money/2011/07/12/what-the-durbin-amendment-means-for-you.

[87] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, 2009 INTERCHANGE REVENUE, COVERED ISSUER COST, AND COVERED ISSUER AND MERCHANT FRAUD LOSS RELATED TO DEBIT CARD TRANSACTIONS (June 2011), http://www.federalreserve.gov/paymentsystems/files/debitfees_costs.pdf.

[88] Jennifer Tescher, *Durbin's Unintended Consequences for the Underbanked*, AM. BANKER (July 26, 2011).

[89] Wilshusen, et al., *supra* note 28, at 6.

of prepaid cards in an effort to switch debit card users to prepaid cards or to attract new customers may offset 20–50 percent of the losses in debit interchange revenue.[90]

Prepaid cards, however, are not entirely free of the Durbin Amendment's reach. For the purposes of 15 USCA § 1693o-2, "debit card" is defined to include general-use prepaid cards, as set forth in 15 U.S.C.A. § 1693l-1(a)(2)(A).[91] "Small issuers,"[92] those with assets below $10 billion, are exempt.[93] Prepaid cards issued by banks with more than $10 billion in assets, however, are exempt only if they do not provide access to funds by check, Automated Clearing House (ACH), or wire transfer. This narrow exception, which Congress intended to keep large banks from evading the Durbin Amendment's price controls by effectively converting prepaid cards into de facto debit cards, means that large banks can only offer prepaid cards with reduced functionality, and in particular, cannot offer online bill pay, recurring ACH debit (such as to pay utility bills), or funds transfer among different accounts (such the transfer of funds from a prepaid card to an interest-bearing savings account). If large banks offer those functions, they become subject to the Durbin Amendment's price controls on interchange fees. Thus, at the same

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[90] A New Report from Aite Group, Recouping Lost Debit Interchange Fees with Prepaid Cards, http://www.aitegroup.com/Reports/ReportDetail.aspx?recordItemID=770.

[91] The term "debit card"—

> (A) means any card, or other payment code or device, issued or approved for use through a payment card network to debit an asset account (regardless of the purpose for which the account is established), whether authorization is based on signature, PIN, or other means;
> (B) includes a general-use prepaid card, as that term is defined in section 1693*l*-1(a)(2)(A) of this title; and
> (C) does not include paper checks. 15 USCA § 1693o-2(c)(2).

15 U.S.C.A. § 1693l-1(a)(2)(A) defines "general-use prepaid card" as a card or other payment code or device issued by any person that is—

> (i) redeemable at multiple, unaffiliated merchants or service providers, or automated teller machines;
> (ii) issued in a requested amount, whether or not that amount may, at the option of the issuer, be increased in value or reloaded if requested by the holder;
> (iii) purchased or loaded on a prepaid basis; and
> (iv) honored, upon presentation, by merchants for goods or services, or at automated teller machines.

[92] A "small issuer" includes "any issuer that, together with its affiliates, has assets of less than $10,000,000,000." 15 USCA § 1693o-2(a)(6)(A).

[93] 15 USCA § 1693o-2(a)(6), (7).

time that the Durbin Amendment has swelled the ranks of the underbanked, it could also stifle the evolution of prepaid cards into low-cost substitutes for bank accounts for unbanked and underbanked consumers.

Moreover, by forcing traditional banks to offer cards with reduced functionality, the Durbin Amendment deprives consumers of potential benefits that banks are uniquely positioned to offer. For example, when the consumer website NerdWallet.com surveyed the prices of prepaid cards, it found that both of the two least-expensive cards were issued by large banks.[94] The Chase Liquid card is especially instructive: for a monthly flat fee of $4.95, it offers free usage of Chase's 17,000 ATMs; free access to its 5,500 branches; free customer service with a live agent; free reloading through ATMs, branches, or mobile banking; and even free paper bank statements. Chase has designed the Liquid card as an alternative to a traditional checking account. As one review notes, however, "the Liquid card doesn't [offer] much in the way of an automatic online bill pay option."[95] What the review failed to note, however, is that Chase is unable to provide Liquid with an online bill-pay feature and some other functionality because if it did it would trigger the Durbin Amendment's interchange price controls. Notably, American Express's low-fee Bluebird card offers automatic bill pay—but only because as a non-bank it is not covered by the Durbin Amendment and so can offer bill pay without triggering the Durbin Amendment's interchange price controls.[96]

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[94] The two cards were U.S. Bank Convenient Cash Card ($39 per year) and Chase Liquid ($59 per year), NerdWallet.com, *Out of 71 Prepaid Debit Cards, Find the One for You*, NERDWALLET.COM (visited October 4, 2012), http://www.nerdwallet.com/prepaid/.

[95] Jill Krasny & Zachary Floro, *Chase's New Prepaid Card Actually Looks Like a Decent Product*, BUSINESSINSIDER.COM (July 10, 2012), http://www.businessinsider.com/reviewing-chases-new-prepaid-card-chase-liquid-2012-7.

[96] *See* Matt Townsend, *Wal-Mart Offers Bank Account Option with American Express*, BLOOMBERG.COM (Oct. 9, 2012), http://www.bloomberg.com/news/2012-10-09/wal-mart-offers-bank-account-option-with-american-express.html.

Other exemptions from the Durbin Amendment's reach include reloadable prepaid cards that are either government-issued or that meet the criteria set forth in § 1693o-2(a)(7)(A)(ii), namely, that the cards cannot be used to access funds held in a separate account, such as a bank account (i.e., are not essentially debit cards).[97] Notwithstanding these exemptions, the Durbin Amendment became effective July 21, 2012,[98] for interchange transaction fees charged with respect to government-issued prepaid cards, and for § 1693o-2(a)(7)(A)(ii)-compliant prepaid cards subjecting the cardholder to either of the following: (1) a "fee for an overdraft, including a shortage of funds or a transaction processed for an amount exceeding the account balance" or (2) a "fee imposed by the issuer for the first withdrawal per month from an automated teller machine that is part of the issuer's designated automated teller machine network."[99]

III. The Economics of Prepaid Cards: Who Uses Them and Why?

General-purpose prepaid cards occupy a unique position in the payments landscape. In terms of functionality they are virtually identical to credit cards and debit cards. Each of the three carry fees, and in theory these products compete against one another. The primary differences are

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[97] Exempt reloadable prepaid cards include those that are government-issued or in compliance with a five-factor test. 15 USCA § 1693o-2(a)(7)(A). Factors include any "plastic card, payment code, or device" that is—

> (I) linked to funds, monetary value, or assets which are purchased or loaded on a prepaid basis;
>
> (II) not issued or approved for use to access or debit any account held by or for the benefit of the card holder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis);
>
> (III) redeemable at multiple, unaffiliated merchants or service providers, or automated teller machines;
>
> (IV) used to transfer or debit funds, monetary value, or other assets; and
>
> (V) reloadable and not marketed or labeled as a gift card or gift certificate. 15 USCA § 1693o-2(a)(7)(A)(ii).

[98] The exception set forth in 15 USCA § 1693o-2(a)(7)(B) applies "after the end of the 1-year period beginning on the effective date provided in paragraph (9)." 15 USCA § 1693o-2(a)(9) provides that the subsection "shall take effect at the end of the 12-month period beginning on July 21, 2010." *See also* 12 CFR 235.5(d).

[99] 15 USCA § 1693o-2(a)(7)(B).

temporal, not functional. Consumers pay for prepaid card purchases prior to use, debit card purchases contemporaneously with use, and credit card purchases after use.

What historically has distinguished prepaid cards from debit and credit cards is the user base, not the basic product. Prepaid cards users traditionally have been unbanked as well as lower-income, less educated, less financially sophisticated, and with fewer payments options than consumers with bank accounts. For this group, the relevant comparison is not debit and credit cards (to which they have little access) but rather cash-based financial services that cater to unbanked individuals, most notably check cashers and money orders. Prepaid cards offer superior functionality, convenience, and price compared to these alternatives.

Yet, this picture is changing rapidly as prepaid cards become increasingly mainstream. As competition has increased, fees have fallen and functionality has risen, thus some consumers are choosing prepaid cards voluntarily over debit and credit.

A. Profile of Prepaid Card Customers

There has been little systematic research of the demographic profile of prepaid card customers. Historically, prepaid card users were comparable to those who use alternative financial products generally—relatively young, lower-income, and with tarnished credit or otherwise excluded from the mainstream financial system. But as GPR prepaid cards have become more popular, they have also become more mainstream demographically and have prospered in certain middle-class niches.

The unintended consequences of recent regulatory interventions have been particularly important in promoting adoption of prepaid cards by two groups. The first group is low-income consumers, who have been driven out of the banking system by new fees and other costs that have been byproducts of the Durbin Amendment, by new restrictions on overdraft protection, and by the CARD Act. The second group is younger consumers, who in addition to facing many of the same limits as low-income consumers (small average balances and an inability or unwillingness to pay new bank fees),[100] have also found it much more difficult to gain access to credit cards since the enactment of the CARD Act, which limits credit card access for those under 21. At the same time, the virtual disappearance of check-writing by younger consumers has further promoted a reliance on electronic payments. Finally, unique product attributes such as parental control features have opened up prepaid cards to a new market range, such as children away at college.

In one of the first studies of prepaid card customers, Rhine et al. studied 1,917 prepaid cardholders in 2007 to examine their demographic profiles and patterns of card usage.[101] They found that prepaid card users were young: 82 percent were under the age of 45.[102] They found that most cardholders carry modest balances and use their cards primarily to pay bills and make POS transactions, but some appeared to use them as a substitute for a traditional bank account. For example, although most users reloaded their cards infrequently, 16 percent loaded them twice or more a month. In addition, those who reloaded more frequently also made larger value loads on average, suggesting that they used their cards as a substitute for a traditional bank account.

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[100] For example, according to one study, 21 percent of Gen Y consumers do not have a checking account, compared to a national average of 12 percent. Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, at 25.

[101] Sherrie L.W. Rhine, Katy Jacob, Yazmin Osaki, & Jennifer Tescher, *Cardholder Use of General Spending Prepaid Cards: A Closer Look at the Market* (Feb. 2007), http://cfsinnovation.com/system/files/imported/managed_documents/general_spending_prepaid_cards.pdf.

[102] *Id.*; *see also* Ronald J. Mann, *Adopting, Using, and Discarding Paper and Electronic Payment Instruments: Variation by Age and Race*, FED. RES. BANK OF BOSTON CONSUMER PAYMENTS RES. CENTER PUB. POL'Y DISCUSSION PAPER No. 11-2 (May 2011) (finding prepaid card users to be younger on average than debit or credit card users).

For withdrawals, Rhine et al. found that the average value of a POS transaction was $39.48 and the funds withdrawn from ATMs averaged $41.35 per transaction. The average cardholder had a monthly utilization rate of 92 percent, indicating that most of the funds that were added to the account were later spent. Seventy-one percent of the funds were used for POS transactions and 22 percent were withdrawn from ATMs, suggesting that the primary usage was for electronic payments rather than to access cash. Those who loaded funds less frequently also tended to have higher utilization rates and were somewhat more likely to use their cards for POS purposes than for ATMs compared to those who loaded their cards more frequently. Those who loaded their cards more frequently (two or more times per month) made an average of 2.2 ATM and 9.6 POS transactions per month. Forty-five percent of cardholders did not access their accounts through an ATM during the month, and 28 percent did so less than once per month. As with deposits, those who accessed their accounts more than twice per month also tended to make larger ATM withdrawals than those who used them less frequently. For POS transactions, only 6 percent of those surveyed did not use their cards at all during a month, and 27 percent did so less than once per month. However, 14 percent made POS transactions three to five times per month and 24 percent did so more than five times per month.

In 2009, Gordon, Romich, and Waithaka conducted in-depth focus group interviews with 12 AccountNow prepaid card customers and 10 NetSpend prepaid card customers.[103] They found that the typical cardholder was low income, with a median post-tax personal income of $17,500 for AccountNow customers and $22,100 for NetSpend customers. They also found a substantial income range: the AccountNow customers in the survey had incomes ranging from $15,000 to $160,000, and the NetSpend customers' incomes ranged from $12,000 to $55,000. In addition, the prepaid card users surveyed were significantly less likely than the general population to own

[103] Gordon, Romich & Waithaka, *supra* note 35.

a home: only 25 percent of the AccountNow customers were homeowners and none of the NetSpend customers owned their homes. Debt levels were significant relative to income levels for participants in the survey: fewer than 20 percent had no debt, and median debt levels were $10,000 and $8,250 respectively for AccountNow and NetSpend customers, with the range being up to $45,000 for AccountNow's customers and up to $175,000 for NetSpend's. The overwhelming number of debts for these prepaid card users were from unpaid bills—especially unpaid utility bills and unpaid bank fees (which often had led to the termination of the account). Over three-quarters of both AccountNow and NetSpend customers reported unpaid utility bills and bank fees. A significant number also reported credit card debt and unpaid medical bills, which accounted for the bulk of the amounts in dollar terms. They also found that for NetSpend customers, 99 percent were U.S. citizens,62 percent had a high school education or less, 55 percent were white, 22 percent were black, 20 percent were Hispanic, and 73 percent earned less than $50,000 per year.[104] Most of NetSpend's customers carried small balances and used their cards for small transactions. They also found that the prepaid card customers in their study paid two to three bills per month using their cards (typically phone bills, utility bills, and car payments; they also used their cards for online shopping.[105] These data show that at that time, prepaid cards were still largely an alternative financial product.

More recent studies indicate that prepaid cards are becoming more mainstream and middle class. A study by the Aite Group found that one-third of prepaid card users earn more than $45,000 per year, 34 percent have a college degree or higher, and many have both a checking account and a credit card.[106] It found that 40 percent of those surveyed used their prepaid cards "most frequently" for POS purchases, 27 percent used them most frequently for

[104] Gordon, Romich, & Waithaka, *supra* note 35.
[105] Gordon, Romich, & Waithaka, *supra* note 35.
[106] Aite Group, *GPR Cardholders*, *supra* note 39.

online transactions, and 24 percent used them most frequently to pay bills. Only 9 percent reported using their cards most frequently at an ATM. The survey also found prepaid cards to be especially popular among younger consumers, with 43 percent of prepaid card customers between the ages of 21 and 31 at the time of the study.

A 2012 survey by Javelin Strategy & Research of more than 3,000 Americans also found high rates of usage among unbanked and younger consumers but growing mainstream usage.[107] Javelin found that young and underbanked consumers were almost twice as likely to use prepaid cards as the general population.[108] As noted above,[109] Javelin found a substantial drop in the number of consumers with debit and credit cards while during that same period the percentage of U.S. adults with prepaid cards rose from 11 percent to 13 percent. More than half of underbanked respondents (54 percent) said that they used prepaid debit cards for routine online purchases. Moreover, Javelin found a dramatic rise in the percentage of the population without a checking account, increasing from 8 percent to 12 percent in just one year, from 2010 to 2011. But Javelin also found growing mainstream use of prepaid cards: although 17 percent of those earning under $15,000 per year used prepaid or payroll cards, the second largest group was those earning $75,000 to $99,000 per year (16 percent), and 13 percent of those earning over $150,000 per year owned prepaid cards in 2011.

Javelin's analysis, as well as a NetSpend analysis, also suggests that a growing number of underbanked consumers are using prepaid cards like a traditional bank account.[110] Underbanked prepaid card owners reload their cards more frequently, make larger reloads than other prepaid

[107] Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6.
[108] *Id.* at 6.
[109] *See* Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, and accompanying text.
[110] *Id.* at 14.

card owners,[111] and use their cards much more frequently for POS transactions.[112] NetSpend also reports that by 2011, nearly 42 percent of its cardholders had direct deposit, up from only 14 percent in 2007.[113] Also, according to a 2012 news report, Green Dot states that about half of its customer base uses direct deposit.[114] Wilshusen et al. also find some evidence that some consumers use prepaid cards as a substitute for a checking account, finding that some consumers retain prepaid cards for extended periods and use them intensely and primary for ongoing living expenses, rather than to save and finance large purchases.[115] They also find that ATM withdrawals comprise one-third to one-half of the value taken off the card and that the majority of POS transactions occur at grocery stores, fast food restaurants, and gas stations, which they conclude "suggests that prepaid cards are used primarily to purchase nondurable goods."[116]

Other evidence points to rapid mainstreaming of prepaid card use. Green Dot states that its median customer income is about $45,000,[117] and Schuh and Stavins found that adoption of prepaid cards was highest for the highest income group in their study, those making above $100,000 per year.[118] They found that 26 percent of those with incomes above $100,000 per year had prepaid cards, whereas only 15 percent of those with incomes under $25,000 per year or between $25,000 and $50,000 had prepaid cards. In addition, those who had attended post-graduate school were twice as likely to adopt prepaid cards (27 percent) as those with a high school or degree or less (13 percent). On the other hand, the data collected by Schuh and Stavins are of insufficient granularity to fully explain these patterns of adoption because they includes

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[111] *Id.*, at 14.
[112] *Id.* at 22.
[113] CFPB, Advance Notice of Proposed Rulemaking, *supra* note 25, at 4 (citing 2010 and 2011 NetSpend Holdings Form 10-K).
[114] *See* Fields & Jackson-Randall, *supra* note 2.
[115] Wilshusen, et al., *supra* note 28, at 6.
[116] *Id.*
[117] *See* Fields & Jackson-Randall, *supra* note 2.
[118] Schuh & Stavins, *supra* note 5, at 25 tbl.1.

both open-loop and closed-loop cards as well as cards bought for others (although cards *received* from others are treated separately). Thus the data might include prepaid cards that are being bought for others (such as children in college), closed-loop cards (such as gift cards), or reloadable closed-loop cards (such as Starbucks cards).

Overall, prepaid cards traditionally were aimed at low income and unbanked consumers, and they remain important for those groups and seem to be growing in popularity. But more recent studies and other information indicate that prepaid cards are becoming more mainstream and their demographic base increasingly is reaching toward middle class consumers.

B. Prepaid Cards versus Debit and Credit Cards

Many consumers prefer debit and credit cards to prepaid cards. But many consumers are unable to obtain or maintain a bank account or to use a credit card responsibly. Others may decide that prepaid cards offer sufficient functionality at lower prices than traditional bank accounts or credit cards. In particular, once the entire cost of a bank account or credit card is taken into account, some consumers, especially lower-income consumers, may find prepaid cards less expensive. As a result, there are some consumers who may rationally choose to be unbanked and to use prepaid cards, even if they otherwise could have a bank account and carry a debit or credit card. According to a 2008 survey of 2,799 underbanked and unbanked consumers, 55 percent of unbanked and 18 percent of underbanked consumers actually prefer to use a prepaid card rather than a checking account.[119] And according to another survey, a majority of prepaid card users prefer to use prepaid cards over credit cards.[120]

Research reveals several reasons why prepaid card customers may prefer prepaid cards over bank accounts and credit cards: cost, alienation and distrust of the banking system, imposing self-control on spending decisions, and the growing functionality and similarities of prepaid cards to traditional banking products.

1. Cost

Checking accounts may be more expensive than prepaid cards for many consumers, especially for lower-income consumers who have seen bank fees rise in recent years or those who frequently overdraw their accounts or bounce checks. The cost of prepaid cards may also be lower for consumers with certain usage patterns or who use direct deposit (which enables the waiver of certain fees). The Bretton Woods economic consulting firm estimates that a low-balance bank customer who pays monthly account fees and makes five overdraft transactions per year will pay $179 to $464 per year in bank fees compared to a range of $265.92 to $333.75 for prepaid cards without direct deposit and $97.56 to $238.95 for prepaid cards with direct deposit.[121] Thus, although checking accounts may be less expensive for most consumers (those who do not overdraft their accounts), prepaid cards often will be less expensive for others, particularly those who frequently incur overdraft fees or do not use direct deposit. This is not to say that prepaid cards are less expensive or more expensive for every consumer at every time,

[119] Center for Financial Services Innovation, *Prepaid Card vs. Checking Account Preferences* (2008), http://cfsinnovation.com/system/files/imported/managed_documents/prepaid_oct09_0001.pdf. 18.3 percent of underbanked consumers preferred prepaid cards to checking accounts.
[120] Aite Group, *GPR Cardholders*, *supra* note 39, at 6 (noting that 61 percent of prepaid card users prefer to use prepaid cards compared to only 33 percent that prefer to use credit cards).
[121] Bretton Woods, Inc., *Analysis of Branded General Purpose Reloadable Prepaid Cards: A Comparative Cost Analysis of Prepaid Cards, Basic Checking Accounts and Check Cashing* (Feb. 2012), http://bretton-woods.com/media/3e145204f3688479ffff832affffd524.pdf.

but that in light of consumer heterogeneity, prepaid cards will be less expensive for at least some consumers, so the choice of prepaid cards should be preserved and neither favored nor disadvantaged by regulatory dictates that artificially push consumers toward debit or credit cards.

A study by Javelin Strategy and Research conducted in the spring of 2012 concluded that the annual consumer cost of maintaining a checking account averaged between $192 and $359 per customer.[122] Consumers pay about 21 percent more in fees for basic checking accounts than they did six years ago, and on average pay about $7.72 per month in a combination of monthly and automated teller machine fees, or over $92 per year.[123] According to a NerdWallet.com survey, the average monthly fee for traditional checking accounts at the nation's five largest banks ranged from $5 to $12 unless certain minimum average balance or other similar conditions are met (which is unlikely for those who use prepaid cards), and these sums do not include additional fees that might be assessed.[124] A 2012 survey by MoneyRates.com found that fees on checking accounts rose across the board from 2011 to 2012, including increases in the minimum deposit needed to open an account, the minimum balance needed for free checking, and an increase in average monthly fees from $11.28 to $12.08 per month.[125] A study by Barrington Research estimated that the average checking account costs $279 per year for a typical user compared to prepaid cards, which cost $158.[126] According to a survey of prepaid card users by the Aite Group, 39 percent of respondents "strongly agreed" that prepaid cards cost less than checking accounts—more than twice the number of consumers of alternative financial services

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[122] Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, at 19.

[123] *See* Elizabeth Ody, *Regulation Fuels 21% Surge in Checking Fees*, Bloomberg.com (Feb. 29, 2012), http://www.bloomberg.com/news/2012-02-29/regulation-fuels-21-surge-in-bank-checking-fees-javelin-says.html (citing study by Javelin Strategy & Research).

[124] *See* NerdWallet.com, *NerdWallet Bank Fee Monitor: Average Big-Bank Checking Account Can Cost $110 A Year* (March 8, 2012), http://www.nerdwallet.com/blog/2012/bank-fee-monitor-average-bigbank-checking-account-cost-110-year/.

[125] *See* Barrington, *supra* note 12.

[126] *See* David Sternman, *This Small IPO Stock Could Jump As Much as 70%*, STREETAUTHORITY.COM (Sept. 15, 2011), http://www.streetauthority.com/growth-investing/small-ipo-stock-could-jump-much-70-458578.

who still had bank accounts.[127] And 37 percent strongly agreed that prepaid cards are "better overall" than checking accounts (compared to 15 percent of users of alternative financial services who still had bank accounts). In addition, these studies consider only the direct financial costs of bank accounts versus prepaid cards and ignore other costs such as the "shoe leather" costs of being able to reload cards at over 100,000 retail locations, especially for those who lack convenient access to a bank branch or whose working hours make it inconvenient to bank at a traditional branch.[128]

Pew conducted an in-depth comparison of prepaid and checking accounts using a variety of assumptions about fees and consumer sophistication and concluded that there is "no uniform answer" as to whether prepaid cards more expensive than checking accounts because the answer depends greatly on how consumers use the alternative products.[129] For example, examining the estimated costs for median users of the products, Pew found that for "savvy users" a checking account was slightly less expensive than a prepaid card ($4.50 per month for prepaid cards versus $3.99 for checking accounts). For the median "basic" consumer, however, prepaid cards are less expensive than bank accounts ($22.15 per month for prepaid cards versus $28.00 per month for checking accounts), and for "inexperienced" consumers prepaid cards are substantially less expensive ($28.70 per month for prepaid cards versus a $94.00 per month for checking accounts).[130] According to Pew, therefore, it is difficult to generalize about whether consumers are better off with prepaid cards or checking accounts, but many basic and inexperienced consumers likely will be better off financially using a prepaid card instead of a checking account.

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[127] Aite Group, LLC, *The Debanked: A US$1 Billion Prepaid Debit Card Opportunity*, http://www.aitegroup.com/Reports/ReportDetail.aspx?recordItemID=899 (Feb. 9, 2012).
[128] *See* Testimony of Daniel R. Henry, Chief Executive Officer, NetSpend Holdings, Inc., before the United States Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Financial Institutions and Consumer Protection (March 14, 2012).
[129] PEW, LOADED, *supra* note 50, at 15.
[130] *Id.* at 15–17.

The demographics of prepaid card users also influence the relative superiority of prepaid cards versus bank accounts. Those who use prepaid cards typically do not have a large amount of liquid financial reserves that can be used to maintain a bank account in good standing. According Daniel Henry, CEO of NetSpend, the company's average customer card balance is below $100—far below the minimum balance threshold now required by many banks to be eligible for free checking and thus requiring the customer to pay hefty bank fees in order to maintain a bank account.[131] According to the Pew Foundation, the median minimum account balance necessary to waive monthly fees at most banks is $2,500, a sum that few prepaid card customers are likely to meet.[132]

2. Alienation and Distrust of Banks

A second reason why some consumers might prefer to use prepaid cards instead of bank accounts is alienation from and distrust of the traditional banking system. In fact, it appears that many unbanked consumers who use prepaid cards are so-called "debanked" consumers who had bank accounts previously but abandoned them either voluntarily or involuntarily because of cost and the inability to manage them responsibly. For example, of the twenty-two participants in the study by Gordon, Romich, and Waithaka, all but one had previously had a bank account, but by the time of the study, sixteen of twenty-two did not have a conventional bank account.[133] Their precise reasons for migrating out of the traditional banking system varied, but focused around the costs and complexity of bank accounts: several incurred substantial overdraft or bounced check fees, one account was closed because of a bankruptcy filing, several complained of unexpected

[131] Testimony of Daniel R. Henry, Chief Executive Officer, NetSpend Holdings, Inc., before the United States Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Financial Institutions and Consumer Protection (March 14, 2012).
[132] Ody, *Regulation Fuels 21% Surge in Checking Fees*, *supra* note 123.
[133] Gordon, Romich, & Waithaka, *supra* note 35, at 12.

fees, and others claimed to have been the victims of identity theft or unauthorized account access. In addition, most felt like they had been mistreated or ignored in their efforts to resolve the issues with the banks and were thus alienated from and distrustful of the mainstream banking system.[134]

A March 2012 study by the Board of Governors of the Federal Reserve found that the most commonly cited reason for being unbanked is a general dislike of dealing with banks.[135] The Survey of Consumer Finances also has consistently found that the most common reason given for being unbanked is a dislike of dealing with banks (25 percent of respondents), a response that rose from 22.6 percent of respondents in the 2004 survey to 27.8 percent in the 2010 survey.[136]

Other studies have also found a general distrust of banks by unbanked consumers. A focus group study by the Kansas City Federal Reserve Bank of 76 unbanked and underbanked consumers found high levels of anger and distrust toward and feelings of disrespect from traditional banks.[137] Participants in the study especially complained about what they experienced as "hidden" fees (such as inactivity fees and check order charges) or excessive fees (such as overdraft fees).[138] In some cases consumers were unable to cope with the complexity and

[134] *Id.*
[135] *See* BOARD OF GOVERNORS, MOBILE FINANCIAL SERVICES, *supra* note 3, at 19.
[136] Jesse Brick, Arthur B. Kennickell, Kevin B. Moore, and John Sabelhaus, 98 FED. RES. BULL. (No. 2) at 1, 32 Box 4 (June 2012).
[137] Fed. Res. Bank of Kansas City, *A Study of the Unbanked & Underbanked Consumer in the Tenth Federal Reserve District* 6, FED. RES. BANK OF KANSAS CITY (May 2010).
[138] Note that although they considered these fees to be "hidden," that is a subjective assessment as at least some of the fees may have been unknown at the time or simply reflect a lack of experience or knowledge about bank accounts, but were necessarily hidden or concealed (such as check order fees). In one case, for example, a participant in the focus group reported that he did not realize that he needed to have money in his account in order to use checks; he thought so long as he had checks in his checkbook he could use them. *Id*. at 7. For purposes of the current discussion, however, what matters is in fact the subjective experience of unbanked and underbanked consumers in order to understand their decision-making process as to whether to adopt a bank account.

organizational demands of managing a bank account.[139] They also said that when conflicts arose with the banks over what they believed to be erroneous charges, they "did not feel 'listened to' or 'believed' because of factors such as their lower income, manner of dress or language."[140] By contrast, they said that the costs associated with check cashing services and money orders were more transparent and immediate than those associated with bank accounts, and they found access to those service providers more convenient than access to banks.[141] Hispanic consumers said they felt especially unwelcome by banks because of language barriers, and in some cases Hispanic immigrants cannot even open a bank account or cash a check because they lack adequate identification.[142]

Participants in the study also stated that they felt that the costs of certain inconveniences might be larger and the benefits of a traditional bank account were smaller. For example, because underbanked consumers live closer to the financial edge, they often feel a need to be able access funds immediately rather than waiting through the two or three day hold period until a check clears at a bank. Thus, they put a premium on physical control and immediate access to their money.[143] The benefits of a bank account may be lower as well. For example, several participants reported that they couldn't use a check to pay their rent (their largest bill) but had to use cash or money order.[144]

As a result of the higher costs and feelings of distrust about banks, many unbanked customers implicitly or explicitly forego a bank account and rely on non-bank alternatives even

[139] In one case, for example, a young woman reports that her parents helped her to open a checking account but she was unable to manage it and ended up having the account closed. *Id*. at 7.
[140] *Id*. at 6.
[141] *Id.* at 9. For example, many unbanked consumers have work hours that make it inconvenient to bank during traditional banking hours and the paucity of bank braches in lower-income areas may make it inconvenient to go to a bank, *see id.* at 12, especially if one does not own a car.
[142] *Id.* at 6.
[143] *Id.* at 8.
[144] *Id.* at 8.

if they could have a bank account. In light of the escalating cost of bank accounts on one hand and declining costs of prepaid cards on the other, this decision may be rational. Consumers who prefer prepaid cards expressed several reasons why they use prepaid cards: prepaid cards allow them to impose self-control and typically do not permit them to overdraft or pay more than they have; prepaid cards are less expensive than a checking account; prepaid cards give consumers privacy by allowing them to provide less personal information than a checking account; it is much easier to purchase and load a prepaid card than to open a checking account and make deposits; and you can get a prepaid card without a credit check.[145] In addition, some prepaid cards today offer the ability to save money[146] and offer rewards,[147] which reduces some of the advantages associated with a traditional bank account, debit card, or credit card (especially since rewards on debit cards have been declining since the imposition of the Durbin Amendment).

3. Self-Control and Budgeting

Prepaid card users, especially those who have had difficulty with financial management in the past, also state that prepaid cards help them to control their finances and to avoid overdraft fees. The most common reason (cited by over half of respondents in one survey) is that prepaid cards prevent them from spending more than they have.[148] Although those who use overdraft

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[145] I have omitted a discussion of why consumers might prefer to use prepaid cards instead of checks. Checks are a poor substitute for electronic payments generally, so more relevant is the comparison between debit cards and prepaid cards.

[146] *See supra* note 35 and accompanying text.

[147] The 123 Rewards Card, for example, offers rewards that can be used for gasoline and groceries. *See* http://www.kpfprepaid.com/.

[148] Center for Financial Services Innovation, *Prepaid Card vs. Checking Account Preferences*, *supra* note 119. 18.3 percent of underbanked consumers preferred prepaid cards to checking accounts. See also Bretton Woods, Inc., *Analysis of Branded General Purpose Reloadable Prepaid Cards*, *supra* note 121, at 4 (citing National Urban League, Reloadable Prepaid Cards, Oct. 2011 which found 73% of respondents reported that what they liked most about prepaid cards is that it prevented them from overspending or overdrafting); National Council of La Raza, *Perspectives on Prepaid Cards from Low-Income Hispanic Tax Filers* (April 2011), http://www.nclr.org/index.php/publications/perspectives_on_prepaid_cards_from_low-income_hispanic_tax_filers/ (that over 60% of Hispanics and over 50% of Non-Hispanics reported that one of the things that prepaid card users

protection generally are aware of the cost, there are some consumers who overdraft their accounts inadvertently and incur unexpected fees.[149] Prepaid cards, by contrast, generally do not offer overdraft protection or do so only in a limited manner. Prepaid card users with insufficient funds to cover a purchase typically will have the transaction declined, although there may be instances where there is a delay between the initial authorization of a transaction and its clearing that might lead to an overdraft if other transactions occur in the meantime.[150] In addition, prepaid cards offer additional services that assist consumers in managing their finances, such as providing instant balance updates by text message.[151]

4. Access to Electronic Payments and Other Financial Products

Another benefit of network-branded prepaid cards is that they are accepted almost universally and are indistinct in appearance from credit and debit cards. They carry the logo of one of the major payment networks (Visa, MasterCard, American Express, and Discover), which provides a sense of psychological validity for consumers that often feel excluded from the financial mainstream.[152] A substantial number of prepaid card users pointed to the fact that the cards appeared to be similar to debit and credit cards as an important feature of prepaid cards.[153]

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liked most was that they could spend only the amount of money that they had); and Aite Group, LLC, *The Debanked: A US$1 Billion Prepaid Debit Card Opportunity*, http://www.aitegroup.com/Reports/ReportDetail.aspx?recordItemID=899 (Feb. 9, 2012) (48% of debanked consumers stated that they "strongly agreed" with the statement that prepaid cards are better than a checking account because of the inability to overdraft).

[149] *See* Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 69 WASHINGTON & LEE L. REV. 1141 (2012).

[150] Most prepaid cards do not offer overdraft protection.

[151] PEW HEALTH GROUP, KEY FOCUS GROUP FINDINGS, *supra* note 36, at 4. NetSpend, for example, allows consumers to personalize the notifications that they receive. *See* NetSpend.com, Go Mobile with Anytime Alerts, https://www.netspend.com/why_netspend/powerful_tools/anytime_alerts.shtml.

[152] *See* Gordon, Romich, & Waithaka, *supra* note 35; Bretton Woods, Inc., *Analysis of Branded General Purpose Reloadable Prepaid Cards*, *supra* note 121, at 4 (citing National Urban League, Reloadable Prepaid Cards, Oct. 2011); and Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, at 11 fig.3.

[153] A survey by the National Urban League found that 26% of prepaid card customers reported that one of the things that they liked best about prepaid cards was that they carried the logo of one of the major networks (Visa,

Prepaid cards may also offer a vehicle for credit building if used to pay recurring monthly bills and if the consumer elects to have the payments reported to a credit reporting agency.[154] In fact, celebrity financial advisor Suze Orman developed a new prepaid card expressly touted as providing a feature for creating a credit history and improving one's credit score.[155] Although this feature appears to be uncommon for prepaid cards today, consumers indicate that they would like more cards to add this feature.[156]

Debit and credit cards also require a credit check before approval, and some prepaid card users are unable to be approved for debit or credit card products because of bad credit or negative ChexSystems reports of bounced checks or closed accounts.[157] Thus for those who cannot obtain a debit or credit card because of impaired credit, prepaid cards may be the only product available for electronic or online payments.

C. Prepaid Cards and the Cash Services Economy for the Unbanked

Many unbanked consumers are unbanked involuntarily, not by choice.[158] In addition, consumers in lower-income areas might not have access to a traditional bank because bank

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MasterCard, American Express, and Discover). *See* Bretton Woods, Inc., *Analysis of Branded General Purpose Reloadable Prepaid Cards*, *supra* note 121, at 4 (citing National Urban League, Reloadable Prepaid Cards, Oct. 2011). Javelin's survey found that nearly one-third of prepaid card users said that carrying a major brand that would allow ubiquitous acceptance of prepaid cards would lead them to increase their use of prepaid cards. Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, at 11 fig.3.

[154] *See* Center for Financial Services Innovation, The Nonprofit's Guide to Prepaid Cards 14 (Sept. 2010).

[155] The accuracy of her claim, however, has been challenged. *See*, *e.g.*, Kathy Kristof, *SuzeOrman Card: Rip-Off or Righteous?*, http://www.cbsnews.com/8301-505144_162-57359114/suze-orman-card-rip-off-or-righteous/ (Jan. 16, 2012).

[156] *See* discussion at *supra* note 36 and accompanying text.

[157] ChexSystems is a specialized "private database of consumers who have had deposit accounts closed while holding a negative balance." *See* PEW, LOADED, *supra* note 50, at 35 n.31.

[158] For example, 60 percent of prepaid card users in the Aite Group study expressed a preference to use checking accounts rather than prepaid cards, which suggests that they are unbanked involuntarily rather than by choice. *See* Aite Group, *GPR Cardholders*, *supra* note 39, at 6.

branches are scarce in many neighborhoods.[159] As a result, unbanked consumers are more reliant on cash payments than banked consumers. According to the FDIC's 2011 survey of unbanked households, during the past year 23 percent of unbanked households used nonbank providers for products and services such as money orders, check cashing, or remittances.[160] The survey also found a dramatic growth in the use of prepaid cards by unbanked households in recent years, rising from 12.2 percent in 2009 to 17.8 percent in 2011.[161]

The other financial options available to unbanked consumers are limited primarily to check cashers and money orders. The costs of check-cashing services and money orders are comparable to and probably higher than the cost for prepaid cards, especially once the total costs in terms of time and inconvenience are taken into account, although systematic empirical research is lacking.[162] According to a 2006 report by Consumers Union, for example, check cashers on average charged 4.11 percent to cash a payroll check and 2.44 percent to cash a government benefits check.[163] Participants in the study by Gordon, Romich, and Waithaka reported paying as much as $13 per check, or $40 to $60 per month, to cash checks.[164] Another study estimated that those who use check cashers pay $140 to $720 per year in fees.[165] A recent study by the Bretton Woods economic consulting group estimates that consumers who switch from cash to reloadable prepaid cards can save an average of 56 percent a month by avoiding

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[159] *See* Deyanira Del Rio, *Prepaid Cards & Financial Services in Low Income Communities* (Dec. 1, 2011), *available at* www.fdic.gov/about/comein/DelRioDec11.pdf.
[160] 2011 FDIC National Survey of Unbanked and Underbanked Households, *supra* note 4, at 6.
[161] 2011 FDIC National Survey of Unbanked and Underbanked Households, *supra* note 4, at 6.
[162] G. Michael Flores, *Adding It all Up: How Prepaid Card Fees Compare to Checking Account Fees* (April 2011).
[163] Jean Ann Fox & Patrick Woodall, *Cashed Out: Consumers Pay Steep Premium to "Bank" at Check Cashing Outlets*, Consumer Federation of America (Nov. 2006). The Consumers Union study is the most recent systematic study of check-cashing fees that I have been able to locate, nevertheless those figures appear to be more or less valid today. According to the website of United Check Cashing the fees range from 1 percent to 5 percent depending on the state. *See* UNITED CHECK CASHING, http://www.unitedcheckcashing.com/FAQ.asp. Walmart charges less both for check cashing services ($3 to $6 per check cashed) and for prepaid cards, which are issued for free.
[164] Gordon, Romich, & Waithaka, *supra* note 35, at 19.
[165] Bretton Woods, Inc., *Comparative Analysis of Reloadable Prepaid Cads to Basic Checking Accounts and Check Cashing* 13 (Mar. 2011) (citing study by Chexar Networks, Inc.).

check cashing, money order, and other fees.[166] Also, 27 percent of respondents to the National Urban League survey stated that one of the things they liked most about prepaid cards was that they were cheaper than using a check casher.[167] Moreover, none of these studies accounts for the time, inconvenience, and risk of acquiring cash, thus these estimates surely underestimate the full costs of relying on cash.

Cash and money orders offer limited functionality and flexibility in terms of online shopping or electronic transactions.[168] In addition, using check cashers and money orders incurs additional transaction costs, such as the "shoe leather" costs of going from place to place. Gordon, Romich, and Waithaka's study participants commented that "the card kept them from having to run multiple places to cash a check, buy money orders, and then deliver payments."[169] Prepaid card users find this convenience to be especially valuable for recurrent and predictable financial obligations, such as rent. Moreover, using direct deposit can further increase the convenience of prepaid cards relative to cash alternatives by making money available immediately. Paying a bill by using a check casher or money order typically incurs a delay in posting time of 24 to 72 hours as compared to immediate payment by prepaid card. Prepaid cards can also be loaded conveniently; according to one study, the most popular way to reload a card, used by almost half of prepaid card holders, was to reload the card online.[170]

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[166] Press Release, Network Branded Prepaid Card Association, Reloadable Prepaid Cards Are Low-Cost Options Compared to Other Financial Tools According to Annual Bretton Woods Analysis (Mar. 12, 2012), http://www.nbpca.org/~/media/680D717219DB40209EE0CAC1EF6D3079.ashx (citing Bretton Woods, *Analysis of Branded General Purpose Reloadable Prepaid Cards*, *supra* note 121).
[167] *See* Bretton Woods, Inc., *Analysis of Branded General Purpose Reloadable Prepaid Cards*, *supra* note 121, at 4 (citing National Urban League, Reloadable Prepaid Cards, Oct. 2011).
[168] Although it is technically possible to shop online using a money order, many major sites (such as Amazon.com, *see* http://askville.amazon.com/guys-accept-money-orders/AnswerViewer.do?requestId=76431899) do not accept checks or money orders and where money orders are accepted the process is highly cumbersome and time-consuming.
[169] Gordon, Romich, & Waithaka, *supra* note 35, at 12. *See also* Fed. Res. Bank of Kansas City, *supra* note 137, at 9 (describing routines used by unbanked consumers to pay bills and organize their finances).
[170] Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6, at 29.

In addition, carrying cash can be dangerous and raises the risks of crime and loss. Thus, consumers tend to use electronic payments more frequently in high-crime areas.[171] The National Urban League survey found that the second-most common reason for using prepaid cards, stated by 41 percent of respondents, is that they were easier to use and safer than carrying cash.[172] Over 40 percent of those in a National Council of La Raza study also stated that one of the things they liked most about prepaid cards was not having to carry cash.[173] Survey respondents also indicated that using prepaid cards (like other types of electronic payments) instead of cash can make it easier to budget and manage money by creating a transaction history.[174]

Most fundamental, it is exceedingly difficult to function in the American economy today without payment cards of some sort. Activities such as e-commerce, car rentals, and travel all require access to payment cards. According to the Javelin Strategy and Research study, 56 percent of unbanked consumers who own prepaid cards use them regularly for online transactions, compared to 46 percent of all prepaid card customers.[175] Prepaid cards thus serve an important role for unbanked and underbanked consumers. According to a 2009 survey of 400 underbanked prepaid card users by the Center for Financial Services Innovation and the Network Branded Prepaid Card Association, 78 percent of respondents said that their cards were very or

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[171] *See* Todd J. Zywicki, *The Economics of Payment Card Interchange Fees and the Limits of Regulation*, ICLE Financial Regulatory Program White Paper Series (June 2, 2010); *available at* http://www.laweconcenter.org/images/articles/zywicki_interchange.pdf.
[172] *See* Bretton Woods, Inc., *Analysis of Branded General Purpose Reloadable Prepaid Cards*, *supra* note 121, at 4 (citing National Urban League, Reloadable Prepaid Cards, Oct. 2011). This does imply that the other 73 percent thought that check cashers were less expensive, just that prepaid card customers chose to use prepaid cards for reasons other than cost (such as convenience).
[173] National Council of La Raza, *supra* note 148.
[174] *See* Bretton Woods, Inc., *Analysis of Branded General Purpose Reloadable Prepaid Cards*, *supra* note 121, at 4 (citing National Urban League, Reloadable Prepaid Cards, Oct. 2011); National Council of La Raza, *supra* note 148.
[175] Javelin Strategy & Research, *Prepaid Cards and Products in 2012*, *supra* note 6.

extremely useful, 74 percent said they were very likely or certain to recommend the card to others, 60 percent used their cards weekly, and 12 percent used them daily.[176]

IV. Market Failure and Regulatory Responses

For many consumers, prepaid cards are less expensive and more functional than the alternatives. Their decision to use prepaid cards is rational and is consistent with standard economic analysis. Nevertheless, concern has been expressed that prepaid cards are unduly expensive for consumers, especially low-income, less-educated, and less financially experienced consumers who, it is feared, may pay excessively for prepaid cards compared to alternatives. These criticisms have produced calls for regulation of the terms and marketing of prepaid cards. There are two rationales that could support regulatory intervention. First, there may be a market failure as a result of inadequate competition that produces monopoly power in the market and higher prices than would prevail in a competitive market. Second, it might be argued that there is a consumer protection problem—that consumers lack sufficient knowledge or capability to understand the complexity of the product and the fees associated with it. Either way, it could be argued, consumers are harmed by higher prices and lower quality.

Economic theory and available evidence to date, however, fail to support either of these rationales for regulatory intervention. Nor is there any reason to believe that government regulation could be fashioned in such a manner as to improve market outcomes. On other hand, although there is little basis for remedial intervention in the name of competition or consumer protection, more modest market-reinforcing interventions might be considered that could

[176] Center for Financial Services Innovation, *Satisfaction with and Usage of Prepaid Cards*, NBPCA/CFSI Survey Results (Apr. 2009), http://cfsinnovation.com/system/files/imported/managed_documents/nbpca_cfsi_final_3_.pdf.

proactively promote future competition and consumer protection in this market rather than displacing it by regulation.

A. Competitive Failure?

A first potential rationale for regulation would be the existence of a competitive failure that intervention could remedy. But the prepaid card market appears to be exceedingly competitive, and barriers to entry are low. New cards have been entering the market frequently, including cards provided by traditional financial service providers such American Express and major banks, celebrity-branded cards, and cards aimed at particular demographic groups.[177] Moreover, because prepaid cards are marketed to consumers through program officers that serve as a "front man" branding the cards and offering much of the day-to-day operational support for cards while partnering with a network and bank processor in the back office, a company need not be a bank in order to enter the prepaid card market. For example, the two largest prepaid card providers—NetSpend and Green Dot—were not banks when they attained their leadership positions in the market.[178] Barriers to entry in the banking industry, by contrast, are high.

There are other indicators of thriving competition in the prepaid card industry. Many of the new cards feature low and simplified fee structures and the number of fees has been declining over time.[179] The total price of holding and using prepaid cards has been falling in recent years even as the cost of traditional bank accounts has been trending up, especially for lower-income consumers.[180] The quality of prepaid cards has also risen even as prices have fallen in the wake

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[177] *See* Andrew R. Johnson, *Flood of Competition Weighs on Pre-Paid Card Companies*, WALL ST. J. (July 27, 2010), http://online.wsj.com/article/BT-CO-20120727-714360.html.
[178] Green Dot subsequently did acquire a bank but it was not necessary to conduct its business.
[179] *See* discussion *supra* at note 94 and accompanying text.
[180] Bretton Woods, *Analysis of Branded General Purpose Reloadable Prepaid Cards*, *supra* note 121, at 10; *See* Keitel, Federal Reserve Bank of Philadelphia, *Federal Regulation of the Prepaid Card Industry: Costs, Benefits, and Changing Industry Dynamics*, 18–19 (April 2010), http://www.philadelphiafed.org/consumer-credit-and-

of heightened competition.[181] Prepaid cards now include new features such as linked savings accounts; web, text, and email alerts; electronic statements; and mobile banking.

A striking feature of the prepaid card industry is the ease by which consumers can switch cards and the fierce competitive efforts exerted to attract new customers. Switching debit cards usually entails switching bank accounts, a difficult and tedious process, especially for lower-income consumers who may have blemished financial records. Switching credit cards can also be difficult for those with impaired credit who may not be approved for a new credit card. Prepaid cards, by contrast, generally require no credit check, and there are minimal transaction costs in switching from one prepaid card to another—indeed, one can even easily transfer funds from one prepaid card to a new one electronically.

Data from the Federal Reserve support the hypotheses of the ease with which consumers can switch prepaid cards compared to alternatives.[182] For example, in 2009 only 9.0 percent of consumers discarded one or more of their debit cards and 16.5 percent discarded at least one credit card (perhaps from involuntarily having their bank account closed or credit card canceled). By contrast, 29.0 percent of consumers had discarded at least one prepaid card. In light of the ease with which consumers can switch loyalties and obtain new prepaid cards, the rivalry from other forms of electronic payments such as debit and credit cards, and the ease of entry and strong competition to attract new customers, there is little reason to believe that there is a competitive market failure in the prepaid card market. As noted, in contrast to the criticism of prepaid cards in the media and by some regulators, prepaid card customers generally express high levels of satisfaction with their cards, consistent with the hypothesis that the market is

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payments/payment-cards-center/events/conferences/2011/C2011-Federal-Regulation-of-Prepaid-Card-Industry.pdf (conference summary describing comments of Green Dot's Steve Streit and MetaBank's Brad Hanson).

[181] *See* Keitel, *supra* note 180.

[182] *See* Foster, et al., *supra* note 24, at 41.

competitive.[183] Moreover, although issuer revenues have grown as the market has grown, I am aware of no evidence that prepaid card issuers are earning sustainable economic profits or "rents" from their operations. In fact, despite growing revenues, the stocks of the industry's largest players (NetSpend and Green Dot) have sagged as a result of heightened entry and competition.[184]

B. Consumer Protection Rationales: Do Prepaid Card Users Understand What They Are Doing?

There could be a market failure that might support government intervention if consumers lack an accurate understanding of the full cost of prepaid cards (compared to relevant alternatives) or are unable to easily compare offers from competing prepaid card issuers. In such a case, intervention might be warranted to reduce fees or to require the disclosure of certain terms or fees.[185]

Based on the available information, however, prepaid card customers appear to have an accurate sense of the cards' cost. Indeed, the fee structure of prepaid cards does not seem any more complicated than those for credit cards or checking accounts, both of which are quite complicated. And, as noted, many consumers who use prepaid cards do so precisely because these cards are less complicated than the myriad fees and rules associated with checking accounts or credit cards. Almost three-quarters of prepaid card users in a 2009 survey said that the fees for using their cards were fair, and an even greater number said that they understood the

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[183] *See* discussion at *supra* notes 38–39 and accompanying text.
[184] *See* Johnson, *Flood*, *supra* note 177. In fact, to the extent that any barrier to entry exists, it is the perverse effects of the Durbin Amendment, which has chilled entry by larger banks. *See* discussion *infra* at note 194 and accompanying text.
[185] This assumes, of course, that any such intervention is well-tailored to address and correct the identified problem.

fees well.[186] Interviews by Gordon, Romich, and Waithaka revealed that consumers found the fee structures of prepaid cards to be transparent and easy to understand, that they knew the fees for their transactions, and that there will not be any unexpected fees.[187] They also thought the fees charged were fair.[188] This sentiment is echoed anecdotally in the Pew Focus Group study, as one participant commented, "I think [prepaid card fees] are fair because they're upfront. I'm thinking in contrast to a checking account . . . [where] they're going to whammy you with fees on the backside. Whereas with prepaid debit cards they're very upfront. This is the cost of the card, this is the cost for the services. It's up to you at that point."[189]

Moreover, consumers who use prepaid cards state that they understand the kind and amount of fees on prepaid cards better than they do for debit or credit cards. Indeed, despite the myriad fees on prepaid cards, the number of potential fees on checking accounts and credit cards is even larger. Consumers' confusion and lack of comprehension about the terms and fees of bank accounts is what led many of them to reject the traditional banking system in favor of the simpler and more transparent pricing scheme of prepaid cards.[190]

Prepaid card users also appear to have an accurate sense of which fee combinations are most suitable for their particular situations. NetSpend, for example, offers two different payment plans: one with a monthly fee and free POS transactions (plus a few other a la carte fees) and another plan that charges no monthly fee but does charge a per-transaction fee. Seventy-four percent of NetSpend's customers choose the per-transaction rather than monthly-fee plan.[191] According to data provided to the author by NetSpend, its customers overwhelmingly choose the

[186] Center for Financial Services Innovation, *supra* note 176.
[187] Gordon, Romich, & Waithaka, *supra* note 35, at 19.
[188] Gordon, Romich, & Waithaka, *supra* note 35, at 19.
[189] PEW HEALTH GROUP, KEY FOCUS GROUP FINDINGS, *supra* note 36, at 1.
[190] *See* Gordon, Romich, & Waithaka, *supra* note 35, at 13.
[191] Data on file with author.

correct card and adjust their choices over time to correct any errors. Seventy-four percent of NetSpend's customers choose the least-expensive fee plan for their card usage. Five percent pay monthly but do not use the card frequently enough to justify the flat fee, and 21 percent pay on a per-transaction basis but use the card enough that the monthly fee plan would be optimal.[192] Users select a card plan at the time of activation, but about 11 percent switch from one plan to another during their tenure and NetSpend has a proactive outreach program to inform customers of less-expensive options.[193] Thus, an overwhelming number choose the right plan for their usage patterns and can easily switch to another plan or another card issuer if they make mistakes. As a result, if regulation were to foreclose options for consumers—such as the proposed Menendez legislation (described in part II) that would prohibit cards with per-transaction fee pricing—hundreds of thousands would pay higher fees or possibly abandon prepaid cards completely.

C. Market-Reinforcing Regulation

Although there have been many criticisms in the abstract that consumers do not understand the cost and fee structure of prepaid cards, or that the price of prepaid cards is simply "too high" in some absolute sense, advocates of intervention have provided no tangible evidence that this is actually the case. Thus, while deep regulatory intervention is unwarranted, milder, market-reinforcing regulation may be worthy of consideration, however, to address some to promote more robust competition and consumer choice in the market.

[192] Note that the asymmetric distribution of errors toward the no monthly fee card could result from a variety of sources: an underestimation of the expected frequency of card usage, liquidity constraints that might make the monthly fee more burdensome for some customers, or an endogeneity effect, that consumers who elect the monthly fee card then proceed to use it more.
[193] By phone and through the website and when a customer calls in with a customer service question the representative can review the customer's account and suggest changes. Email communication between author and NetSpend, on file with author (Sept. 18, 2012).

In fact, the biggest single obstacle to increased competition and consumer welfare today is not any failure of competition of consumer protection, but rather the Durbin Amendment. And the single most effective act that could be taken to benefit consumers and market competition would be simply repeal it and allow interchange fees to be set by market forces and for debit cards and prepaid cards to compete on a level playing field. Large banks have the potential to place tremendous competitive pressure on incumbents in the prepaid card industry through the particular mix of low card fees and features that they can provide (such as branches and in-network ATMs). In addition, large banks appear to be uniquely positioned to develop prepaid cards that can function as alternatives to bank accounts or as a bridge from prepaid cards into bank accounts and other traditional banking services for customers who desire them. The Durbin Amendment chills this competitive pressure by forcing large banks to choose between offering cards with reduced functionality and features or exposing themselves to the Durbin Amendment's interchange fee price controls (which, if applicable, would force large issuers to raise other fees or reduce services instead).[194] This arbitrary restraint on competition is harmful to consumers.

Another area where government intervention may be appropriate relates to the pass-through of FDIC insurance on customer account balances in the event the prepaid card issuer fails.[195] Most prepaid cards are issued by a program manager (such as NetSpend) that collects the customer's money and then, for administrative purposes, deposits it in a pooled account with its other customers' money. The account is held in the name of the program manager. Once the funds have been pooled, the total amount of the program manager's account will easily exceed

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[194] *See* discussion *supra* at notes 94–95 and accompanying text.
[195] For a brief explanation, *see* Network Branded Prepaid Card Association, *Prepaid Cards and Deposit Insurance* (accessed Sept. 18, 2012), *available in* http://www.nbpca.com/en/Government-Affairs/Policy-Positions/Deposit-Insurance.aspx.

the $250,000 limit for FDIC insurance. In theory, this arrangement could provide insecurity for customers' funds. In practice, however, the FDIC has issued guidance to banks on how to preserve FDIC pass-through insurance on individual cardholders' accounts.[196] Thus, it appears that every prepaid card backed by a bank—which apparently includes every major prepaid card in the market today except for those issued by American Express[197]—provides FDIC pass-through insurance for its customers.[198] According to the Pew Study, more than 90 percent of the prepaid card programs that it studied suggested that they offered FDIC deposit insurance pass-through.[199] Moreover, most consumers seem to believe that their deposits are insured.[200] In practice, the lack of FDIC pass-through appears to be a problem more theoretical than real, suggesting that both the benefits and costs of mandating FDIC pass-through would likely be small.

Some uncertainty also exists about consumer protection from fraud or unauthorized use of prepaid cards. Fraud protection for prepaid cards is not required by the Electronic Funds Transfer Act, and the CFPB has issued an Advance Notice of Proposed Rulemaking on the question of whether to extend Regulation E to prepaid cards.[201] Nevertheless, all of the prepaid

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[196] *See also* FDIC General Counsel's Opinion No. 8, "Insurability of Funds Underlying Stored Value Cards and Other Nontraditional Access Mechanisms," 74 FED. REG. 67155 (Nov. 13, 2008) (describing process for providing deposit insurance for prepaid cards).

[197] American Express cards are not FDIC insured because American Express is not a bank and pools rather than segregating its customers' accounts. *See* Bank Talk, *More About the Amex Prepaid Card*, BANKTALK.ORG, http://banktalk.org/2011/06/24/more-about-the-amex-prepaid-card/ (June 24, 2011). The funds on American Express cards are protected by state transmitter laws. *See* Consumer Action, *Prepaid Card Survey—2012* (April 12, 2012), http://www.consumer-action.org/downloads/press/2012_Prepaid_Card_Survey.pdf.

[198] *See id*. The universality of providing FDIC pass-through insurance has been driven in part by a requirement that any bank providing clearance services for federal government benefit cards must comply with FDIC regulations in order to offer FDIC pass-through insurance in order to be eligible to offer those cards. *See* Department of the Treasury, Financial Management Service, Interim Final Rule, "Federal Government Participation in the Automated Clearing House," 31 C.F.R. Part 210 (Dec. 22, 2010), http://www.fms.treas.gov/ach/31cfr210_int_final.pdf. Once established, the same mechanisms used for federal government programs apply to private prepaid cards as well.

[199] PEW, LOADED, *supra* note 50, at 4. Only 3 of 52 card programs expressly stated that they did not offer FDIC pass-through, 23 claimed to offer pass-through, and disclosures were unclear for 26.

[200] *See id*. at 4.

[201] Advance Notice of Proposed Rulemaking – Prepaid Cards, [Docket No. CFPB–2012–0019], RIN 3170–AA22, Electronic Fund Transfers (Regulation E).

cards Pew studied offered some type of contractual protection for unauthorized transfers.[202] Pew claims these contractual protections generally are not as "favorable as the protections that are guaranteed to checking account holders by EFTA" and are contractual provisions subject to revision at any time.[203] In practice, however, issuing networks offer fraud protection on prepaid cards similar to that offered on debit cards, and as one commentator has observed, "Although issuing banks are not mandated to offer this protection on prepaid cards, competition in the industry has led to many prepaid cards with liability protection."[204] Thus, again, both the benefits and costs of extending Regulation E protection to prepaid cards may be relatively small. On the other hand, certain features of Regulation E, such as the period of time during which a bank can hold up a suspicious charge and the requirement to issue periodic statements to customers, may be ill-suited to prepaid cards because of the heightened potential for fraud and because the "transient" nature of prepaid card customers could make recovery difficult in the event that a disputed charge is later decided in favor of the issuer.[205]

It has also been proposed that the industry adopt a standardized format for disclosure of prepaid card fees modeled after the Schumer Box for credit cards.[206] Pew's analysis found that disclosure of card fees was often incomplete and it was often difficult to tell whether a card had a

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[202] PEW, LOADED, *supra* note 50, at 20.
[203] *Id.*
[204] Douglas A. King, *Dispelling Prepaid Card Myths: Not All Cards are Created Equal*, PORTALS AND RAILS, FED. RES. BANK OF ATLANTA (Jul. 5, 2011), http://portalsandrails.frbatlanta.org/2011/07/dispelling-prepaid-card-myths-not-all-cards-created-equal.html.
[205] For discussion, *see* Letter from Mary Mitchell Dunn, CUNA Senior Vice President and Deputy General Counsel, Credit Union National Association to Monica Jackson, Office of the Executive Secretary Consumer Financial Protection Bureau (CFPB), regarding Advance Notice of Proposed Rulemaking – Prepaid Cards, [Docket No. CFPB–2012–0019], RIN 3170–AA22, Electronic Fund Transfers (Regulation E), http://www.cuna.org/download/cl_072312.pdf (July 23, 2012).
[206] *See* David Newville, Center for Financial Services Innovation, *Thinking Inside the Box: Improving Consumer Outcomes Through Better Fee Disclosure for Prepaid Cards* (Mar. 2012), http://cfsinnovation.com/system/files/CFSI_Prepaid%20Cards%20Whitepaper%20FInal_0.pdf.

certain fee.[207] And although most prepaid card customers have stated that they understand their card fees, the National Urban League found that 24 percent of survey respondents did not understand all of the card fees when they acquired their cards and 23 percent claimed that they were charged an unexpected fee, suggesting some room for improvement in disclosures to assist consumer understanding and comparison shopping.[208] These remaining problems may prove self-correcting as a result of the trend toward eliminating fees and as consumers gain experience with the product.

A standardized disclosure format could be useful to consumers and to the competitive process by enabling consumers to find more easily the card that is most appropriate for their purposes. Care must be taken, however, to ensure that the information is provided in a user-friendly way and that the fees required to be disclosed in the standardized format are those that are actually relevant to consumers. Any disclosure should also be subject to periodic review and updating in light of product innovations and changing consumer preferences. In addition, regulators should copy-test any mandated disclosures to ensure that they actually improve consumer comprehension and decision-making.

V. Conclusion

Network-branded prepaid cards have emerged as an important and rapidly-growing sector of the retail consumer banking system. The regulatory onslaught of the past several years has increased demand for prepaid cards as regulation has raised the costs of and reduced access to debit and

[207] For example, Pew found that 30 cards disclosed a fee to speak to a live customer service representative, 11 disclosed it as free, and 11 cards did not disclose whether there was a fee to speak to a customer service representative. *See* PEW, LOADED, *supra* note 50, at 3.
[208] *See* Linkage Research, *supra* note 38, at 2.

credit cards, especially among lower-income and younger consumers. At the same time, the need for access to electronic payments has increased.

Prepaid cards have crept toward the mainstream of the consumer payments market, spurring greater competition and producing higher quality and lower cost for customers—a dramatic contrast from the rising price of traditional bank accounts. Although prepaid cards may seem expensive, those who use them appear to do so rationally. To date, no one has identified a cognizable market failure or failure of consumer protection that would justify remedial governmental intervention.

Given the regulatory havoc wreaked on the debit and credit card systems during the past several years, prepaid cards have increasingly become a final resort for many consumers unable to gain other access to the functionality of electronic payments. In light of this reality, regulators should move exceedingly cautiously before taking steps that could critically harm this dynamic and evolving market that provides value and choice to millions of Americans.