

## Study

April 2013

### Are Prepaid Cards Replacing Checking Accounts? New Cards Have No Fees and Offer Online Bill Payment

#### Executive Summary

Prepaid cards are currently the fastest growing type of payment and that trend is expected to continue. They look like a credit card and act like a bank account. Once considered an option only for folks with bad credit, their popularity is expanding. Why?

Prepaid cards used to be laden with fees, but the newest card offerings are virtually fee-free and a practical option for many people who once used checking accounts and credit cards to manage their finances. Prepaid cards also keep debt in check since consumers can't spend more than the preloaded balance.

This study explores how prepaid cards have evolved to accommodate not only the underbanked population, but also dissatisfied bank customers. We also look at how the use of prepaid cards will continue to expand by targeting young users.

According to our report, consumers are turning to prepaid cards to avoid bank fees on their checking accounts, and to avoid getting in over their heads with a line of credit on a traditional credit card. The latest card offerings target younger consumers to groom them as future life-long prepaid card users, who may one day ask "What is a checking account?"

#### The Way it Was

Today's banks bear little resemblance to those of a generation ago. Totally free checking is nearly extinct. Banks charge a fee for ATM withdrawals, too many transactions, and if you don't keep the right balance.

In 1980 the relationship between banks and consumers was more beneficial to the consumer. The prime rate was 20 percent with treasury yields at nearly 11.5 percent. This made savings accounts and Certificates of Deposit a viable means of wealth appreciation.

Today, it's different. Keeping your money in a bank can actually cost you money. Fees have been on the rise since interest rates were deregulated in 1978. In 1996, more legislation allowed financial institutions to charge whatever they considered necessary, opening the door for some of the fees we see today.

Checking and savings accounts were not the only place where consumers were being hit with fees. Credit cards became the cash cow of the banking industry as electronic transactions gave rise to their increased use. Carrying plastic was not only convenient, but a necessity. It became the new target for bank fees.

Congress put a stop to that when it passed the CARD Act in 2009 to regulate the fee structure of credit cards. This put a cap on late fees and over-the-limit fees, and stopped the arbitrary hiking of interest rates. But it didn't stop banks from finding new ways to recoup the lost revenue.

#### Fees, Fees, Fees

Savings and checking accounts started collecting fees like they were toll booth clerks. A typical fee structure is that of Wells Fargo, which charges for each of the following:

- **ATM Fees for out-of-network machines:**
  - \$2.50 per withdrawal or \$5 internationally.
  - \$2 for each balance inquiry or transfer
- **Overdraft Fee - \$35**
- **Stop Payment Fee - \$31**
- **Returned Item Fee - \$12**
- **Monthly Fee - \$7 if the average balance is below \$1,500 or \$9 with paper statements.**
- **Bill Pay Fee - \$3 per month**

Overdraft fees alone created a nice revenue stream for financial institutions. The Center for Responsible Lending found that from 2006 to 2008, 50 million Americans overdrew their bank accounts at least once and 27 million did it five or more times. This created \$24 billion in revenue for banks in 2008 alone. And that was before the recession. As the post-recession economy put further pressure on American households, overdraft fees have risen exponentially.

#### Consumers Don't Like Banks

Some consumers are skilled at avoiding bank fees, but for many spending \$300 or more in annual fees is common. According to a BAI-Finacle survey from 2011, 40 percent of respondents said their bank is more interested in serving itself than serving its account holders. Banks are becoming somewhat more responsive these days as they turn their attention to more customer service, but the days of no fees on checking accounts are gone.

The use of credit cards continues to rise. They are convenient and a necessity for online purchases, and a mainstay in American culture. Nearly half the population carries at least one card and the average consumer has four, according to The Federal Reserve Bank of Boston.

#### By the Numbers: Billions and Trillions

- **2 Billion credit cards in circulation**
- **6.5 Billion is the number of credit card transactions in 2011**
- **\$6 Trillion is the total amount of money spent on those transactions in 2011**

Source: The Nilson Report

Credit cards are only one option in a consumer's financial toolbox. Some people used them irresponsibly though and got in over their heads while others had little choice but to rack up credit card debt due to lost jobs during the recession.

But the bottom line: many consumers are losing the debt battle. According to U.S. Court data, 1.2 million Americans filed for bankruptcy in 2012.

Credit card debt is responsible for more than a few of those filings. According to the Federal Reserve, 176.8 million cardholders are carrying an average balance of \$5,448. If one makes only the minimum payment on that amount, it will take over a decade to pay off (11 years and 3 months to be exact.) And they will pay nearly 50% of the balance in interest payments or around \$2,500.

#### Retirement Funds vs. Fees

Instead of putting those funds into interest or dividend bearing savings or retirement accounts as the previous generation did, many Americans today are giving those funds to the banks in the form of interest payments that average 14 cents on the dollar. A significant portion of take-home pay goes to paying down debt. Americans currently pay 15 percent of their disposable, after-tax income to service debt, according to the Fed.

What's behind this trend? Studies show that consumers spend more when paying by credit card. Cash-only transactions are one way to control spending, but that creates security problems and can't be used for online purchases.

#### What Are Your Options?

A debit card might be a better option than a credit card, but that requires a bank account - more fees. The best choice might be a prepaid card. Yes, a prepaid card. Many of the latest prepaid cards carry little or no fees.

Here are four cards introduced in the past year. They all have ATM access, direct deposit, and bill payment capabilities. They can be used at any place a major credit card is accepted, have customer service 24/7 and charge no monthly fee. They can do just about anything a bank account can do, but for less:

Prepaid Offerings	Introduced	ATM Access	Bill Payment	24/7 Customer Service	Direct Deposit	Monthly Fee
Bluebird by American Express and Wal-Mart	2012	✓	✓	✓	✓	✗
My Vanilla Prepaid Visa Card	2012	✓	✓	✗	✓	✗
Serve from American Express	2012	✓	✓	✓	✓	✗
Discover Cashback Checking	2013	✓	✓	✓	✓	✗

Some even offer rewards like cash back and benefits like roadside assistance that you would normally expect only from a traditional credit card with an annual fee.

Prepaid cards are not new. In the 1970s, college campuses introduced prepaid cards as a payment instrument. In the 1980s prepaid phone cards emerged, and in the 1990s they were packaged as gift cards.




Today, prepaid cards are taking the place of bank accounts for those who either can't qualify or don't have one - known as the underbanked population. The FDIC estimates that 20% of the adult population does not have a bank account. It's also a good choice for those account holders who were mad at all the fees they were getting hit with and closed their bank accounts.

Others use these cards as a debt control strategy. Since the cards only allow charges up to the amount that was preloaded, there is no risk of carrying a balance and paying interest for months as you pay off the debt. And with a power couple like American Express and Walmart in the mix with their Bluebird card, prepaid cards are getting even more exposure in the marketplace. The card is free to sign up for online and you can even order print checks. It's even FDIC insured.

#### Prepaid Cards: Benefits and Uses

Increasingly, prepaid cards are transforming from a product used only by those in financial distress to an alternative to bank accounts and traditional credit cards.

##### Who can benefit from prepaid cards?

- 
**People who don't want to pay fees associated with a traditional bank account.**
- 
**Consumers who don't want a credit card that allows them to run up a balance.**
- 
**Parents teaching their children how to create and adhere to a monthly budget.**

##### What they are being used for:

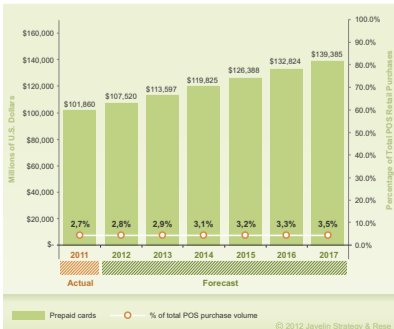
- 
**Perfect for personal budgeting.**
- 
**Good for a child or teenager with a monthly allowance.**
- 
**Shoppers have less of a chance of overspending.**
- 
**Business owners can pre-load cards for employees.**

When prepaid cards were in their infancy, a bank account was a better choice. But with the fee-free options of prepaid cards today that's no longer true. Consumers can now ditch their bank account for the same or less money in fees than a bank account. Chase, one of the largest issuers of traditional credit cards, took notice of the rise in prepaid cards and introduced its Liquid card last year to compete with the prepaid cards that were taking business away.

One of the early innovators in this area was Russell Simmons, who introduced the RUSH card in 2002. And teenagers are the latest target of prepaid card companies. Earlier this year, an Angry Birds card was introduced. Online gaming company, Zynga, has one too, along with a host of celebrities that are sure to impress teenagers.

#### The Future of Prepaid Cards

By eliminating most fees and expenses, the use of prepaid cards is primed for growth. A 2011 Federal Reserve report found that prepaid cards were the fastest growing payment type. According to a study by Javelin Strategy and Research, by 2017, total prepaid card purchasing dollar volume should reach \$139 million - a nearly 37 percent increase from 2011 levels. Percentage of volume is expected to reach 3.5 percent, a 30 percent increase.



#### How to Find the Perfect Prepaid Card

If a prepaid card is in the cards for you, go to [www.creditcardmenu.com](http://www.creditcardmenu.com) to find more information, compare features and apply for a card. There's a card for everyone. Your credit score - or any past financial issues - aren't important because no credit check is required. You have nothing to lose except some of the bank's fees.