

Stored Value Cards: Not Credit, Not Debit, What Are They?

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**15th Annual National Consumer Protection
Week Conference**

April 26, 2005

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COMMUNITY AFFAIRS PROGRAMS FEDERAL RESERVE SYSTEM

Mission:

Engage in outreach, educational & technical assistance activities to help financial institutions, community-based organizations, government entities, and the public understand and address financial services issues affecting low- and moderate- income persons and communities

BACKGROUND

- 2004 Federal Reserve Payments Study
 - 55 % noncash transactions completed by debit or credit card, automated clearing house (ACH) or electronic benefits transfers (EBT)
 - 45 % noncash transactions completed by check

BACKGROUND

Increased use of electronic transactions by consumers:

- participating in the financial mainstream
 - banked (have a deposit account)

- outside the financial mainstream:
 - unbanked (do not have a deposit account)
 - Lower-income, younger, less educated, or a member of a minority group, including immigrants

WHAT ARE STORED VALUE CARDS?

Cards with a magnetic strip on the back that hold information about monies that have been “prepaid” into an account for the purpose of making financial transactions

HOW LARGE IS THE STORED VALUE CARD MARKET?

- Gift Stored Value Cards
 - 2004 - \$79.04 billion transactions
 - 2005 - \$94.84 billion transactions
- Non-Gift Stored Value Cards
 - 2005 - \$107 billion transactions
 - 34 million cards
 - 35 % reloadable general spending cards
 - 30 % government income-support (EBT)
 - 25 % payroll cards
 - 10 % other open-loop cards

STORED VALUE CARD SPECTRUM

- Limited functionality and market acceptance (e.g., closed loop)
- Wide range of functions and broad market acceptance (e.g., open loop)

CLOSED-LOOP CARDS

- Used to make purchases from specific merchants/retailers
 - not tied to a consumer's deposit account
 - not a substitute for a consumer deposit account
- Examples
 - Prepaid telephone cards, transportation cards
 - Specific retailer/retailer group gift cards (ex. dept stores and specialty stores)

OPEN-LOOP CARDS

- **Examples**
 - Payroll cards
 - Reloadable general spending cards
 - Employee flexible benefit accts, child support, and some teen cards
- Some are branded with a bank association logo, providing greater market acceptance
- Card providers include:
 - Financial Institutions
 - Non-Financial Institutions

FOCUS OF DISCUSSION

Stored value cards that most closely resemble the functionality of deposit accounts

- Payroll Cards
- Reloadable General Spending Cards

PAYROLL CARDS

- Cards typically provided through the employer for the employee as a means of paying wage/salary income via direct deposit
- Characteristics depend on employer arrangement with card provider:
 - Obtain cash and check balance at ATM
 - Some payroll cards branded
 - Some payroll cards allow employee to make purchases and possibly pay bills using a debit function

PAYROLL CARDS

- Examples of companies that use payroll cards:
 - U-Haul
 - FedEx
 - UPS
 - McDonalds
 - Denny's
 - Cola Cola
 - BlockBuster Video
 - Office Depot

POSSIBLE EMERGING TREND: PAYROLL CARDS

- Card providers marketing to workers
 - Employer electronically deposits wage/salary income to stored value card account
- Uncertain whether this trend will catch on over time

RELOADABLE GENERAL SPENDING CARDS

- Issued typically by marketer/distributor
- Monies loaded by
 - direct deposit
 - cash or check
 - account-to-account transfer

using designated retail businesses such as convenience stores and check-cashing businesses

RELOADABLE GENERAL SPENDING CARDS

Typically,

- Cash withdrawals or balance inquiries made from ATMs
- Point-of-sale purchases made with debit function
- Bills paid or purchases made using the internet or telephone in a way similar to a credit card BUT monies are prepaid
- Cards are often branded with a bank association logo

FEE STRUCTURES VARY WIDELY

Fee Type	Fee Range
Entrance/Activation	\$0.00 – \$39.95
Maintenance	
Annual	\$0.00 – \$99.95
Monthly	\$0.00 – \$ 9.95
Point of Sale	\$0.00 – \$ 2.00
Domestic ATM (in network)	\$0.00 – \$ 2.50

† Pin-based transactions tend to have higher fees than signature-based transactions.

Source: Center for Financial Services Innovation

OTHER POSSIBLE FEES

- Automated balance inquiry fee
- Live customer service inquiry fee
- Transaction limit fee
- Bill payment fee
- Phone or online transaction fee
- Reload fee
- Money transfer fee
- Out-of-network domestic ATM transaction fee
- International ATM transaction fee
- Inactivity fee
- Overdraft fee
- Overdraft protection fee
- Payday advance fee
- Credit-reporting fee
- Dispute fee

FINDINGS FROM COST COMPARISONS

- The wide range and complexity of card types and features make it difficult to weigh benefits of features against costs
- Cards that have relatively high costs in one fee category often have relatively low fee costs in another category
- Consumer's best choice likely depends on number and type of transactions needed

POTENTIAL ADVANTAGES OF OPEN-LOOP CARDS

- Relative to cash, a safer way to store wage/salary income and possibly other funds
- Ease in making purchases, paying bills and obtaining cash as needed, especially if card branded

POTENTIAL DISADVANTAGES OF OPEN-LOOP CARDS

- **Consumer protections uncertain**
 - Funds insured?
 - Dispute resolution?
 - Periodic statements?
- **May be more costly to consumers than holding a deposit account at a financial institution or using other financial products**
- **Uncertainty about consumer's ability to establish credit**

REGULATION E CONSIDERATIONS

- Regulation E – EFTA establishes the basic rights, liabilities, and responsibilities of consumers who engage in electronic funds transfer services
- provides guidelines about disclosure, liability, and dispute resolution, and provision of periodic statements when electronic transfer services are involved

REGULATION E CONSIDERATIONS

- On Sept 17, 2004, FRB published for public comment proposed amendments to Regulation E.
- In essence, proposed changes would extend the Act's coverage to asset accounts related to direct deposit of wage/salary income onto *PAYROLL CARDS*.

REGULATION E CONSIDERATIONS

- Proposal covers payroll card accounts directly or indirectly established by an employer on behalf of an employee to which EFTs of the employee's wages, salary, or other employee compensation are made on a recurring basis, whether the account is operated or managed by the employer, third-party payroll processor, or a depository institution.

(69 Fed. Reg. 56, 008 (2004))

FDIC INSURANCE COVERAGE CONSIDERATIONS

- In April 2004, the FDIC published a notice and comment for proposed rule that aims to clarify the meaning of 'deposit' as it related to funds at insured depository institutions underlying stored value cards.
- Proposal seeks to further clarify General Counsel's Opinion No. 8 (GC8), issued by the FDIC in 1996, by further opining on the types of stored value card systems that should fall under the FDIC insurance umbrella.
- Three types of stored value systems under consideration

FIRST TYPE OF STORED VALUE SYSTEM UNDER FDIC CONSIDERATION

- (1) Sponsoring company maintains acct at insured depository institution for purpose of making payments on stored value cards.

Monies held in these accts would be insured for sponsoring company and not the cardholder unless FDIC's requirement for "pass-through" insurance coverage are met.

SECOND TYPE OF STORED VALUE SYSTEM UNDER FDIC CONSIDERATION

- (2) Insured depository institution issues stored value cards, maintains a pooled reserve acct (liability for depository inst), and also maintains individual balances or sub-accounts for each cardholder.**

THIRD TYPE OF STORED VALUE SYSTEM UNDER FDIC CONSIDERATION

- (3) Payroll cards. Funds underlying payroll-specific cards would be subject to same rules applicable to other stored value cards and require meeting the “pass through” criteria for cardholder insurance coverage.

NOTE: Proposed rules would exclude gift cards issued by retailers

SOME QUESTIONS YET TO BE ANSWERED

- What motivates a consumer to choose a stored value card rather than a mainstream deposit account?
- Do consumers understand the varying cost structures associated with stored value cards?
- Do consumers understand the potentially limited or nonexistent consumer protections?
- For consumers who choose stored value cards in lieu of mainstream accounts, how will they establish credit or build future wealth?

CONCLUDING REMARKS

- Electronic payments using stored value cards is likely to increase over time
- Forthcoming regulatory changes will likely influence the future of the stored value card market
- Need for personal financial management and other financial education that explains stored value cards

A background article, "Stored Value Cards: An Alternative for the Unbanked?" by Sabrina Su and Sherrie L.W. Rhine can be obtained at:

www.newyorkfed.org/regional/stored_value_cards.html#1

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