THE ECONOMICS AND REGULATION OF NETWORK BRANDED PREPAID CARDS

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Abstract

One of the fastest growing sectors of the consumer payments marketplace is the general-purpose reloadable prepaid card sector. Their importance accelerated as a consequence of new regulations enacted in the wake of the 2008 financial crisis. This increased use of prepaid cards 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, proceed in a largely fact-free environment. This Article describes the current economic and regulatory landscape for prepaid cards. The market appears robustly competitive—in recent years, costs declined, functionality increased, and major players such as American Express and several large banks entered the market. In addition, traditional consumer protection concerns appear to be largely absent, as there is no 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 benefits to consumers. On the other hand, there are some regulations that, if enacted, could promote competition and consumer welfare in this rapidly evolving market.

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INTRODUCTION

The general-purpose network branded prepaid card sector is one of the fastest growing segments of the consumer banking sector. While retail banking operations shrank in response to the 2008 financial crisis and the recession and regulatory responses that followed, the market for prepaid cards grew 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, prepaid card usage is rapidly becoming mainstream, as reflected by the entry of retail financial stalwarts such as American Express, JPMorgan Chase, U.S. Bancorp, and BB&T.[1] Prepaid cards are rapidly recognized as a mainstream consumer payment system, like debit and credit cards.[2]

This Article 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

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1. Gary Fields & Maya Jackson-Randall, *Footnote to Financial Crisis: More People Shun the Bank*, WALL ST. J. (Sept. 12, 2012, 2:54 PM), http://online.wsj.com/article/SB10000872396390444435045776012831427588 56.

2. A fourth front 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 to combine electronic payment capabilities with some traditional banking services. *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., CONSUMERS AND MOBILE FINANCIAL SERVICES 17–18 (2012).

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 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 their 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 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% of all households),[3] an increase from 9 million unbanked households (7.7% of all households) in 2009.[4] Javelin Strategy and Research found that the percentage of consumers without a checking account increased by 50% (from 8% to 12% of the population) from 2010 to 2011.[5] In addition, the FDIC found that approximately 24 million households (20.1% of U.S. households) were underbanked in 2011,[6] an increase from 21 million households (17.9%) in 2009.[7] Rates of unbanked or underbanked households are especially high among non-Asian minorities, lower-

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3. FDIC, 2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 4 (2012) [hereinafter FDIC, 2011 SURVEY], *available at* http://www.fdic.gov/householdsurvey.

4. FDIC, 2009 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 15 (2009) [hereinafter FDIC, 2009 SURVEY], *available at* http://www.fdic.gov/householdsurvey/2009/index.html. The Federal Reserve's 2008 Survey of Consumer Payment Choice reported that 6% of those in the study did not have bank accounts. *See* Scott Schuh & Joanna Stavins, *How Consumers Pay: Adoption and Use of Payments* 6 (Fed. Reserve Bank of Bos. Consumer Payments Research Ctr., Working Paper No. 12-2, 2011).

5. JAVELIN STRATEGY & RESEARCH, PREPAID CARDS AND PRODUCTS IN 2012: ENABLING FINANCIAL ACCESS FOR UNDERBANKED AND GEN Y CONSUMERS 9 (2012). The percentage of consumers with a personal savings account also fell from 72% to 62% of the population. *Id.* at 8 fig.1.

6. FDIC, 2011 SURVEY, *supra* note 3, at 10.

7. FDIC, 2009 SURVEY, *supra* note 4, at 10. 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.*

income households, younger households, and unemployed households.[8]

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 increased the cost of bank accounts to consumers and reduced access to debit and credit cards.[9] Price controls on debit card interchange fees, enacted as part of the Dodd-Frank financial reform legislation and new regulatory limits on overdraft protection, dramatically cut into banks' bottom lines leading banks to impose fees and limits on once free checking accounts. Banks also tightened eligibility for free checking by either 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% of banks offered free checking accounts,[10] down from 45% in 2011, and down by almost half from 76% in 2009.[11] Similarly, a summer 2012 survey by MoneyRates.com found that the percentage of accounts with free checking fell to 35.3%, down from 38.8% a year earlier, and that in 2012, only 22% 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% from 2011, to $5.48 per month, and that the average minimum balance needed to avoid a monthly service fee rose by 23%, to $723.02 (with some accounts requiring an average minimum balance as high as $5,000).[13]

In addition to raising fees, banks reduce costs by reducing services

8. FDIC, 2011 SURVEY, *supra* note 3, at 5.

9. 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.

10. Claes Bell, *Checking Fees Rise to Record Highs in 2012*, BANKRATE.COM (Sept. 24, 2012) [hereinafter Bell, *Checking Fees Rise*], http://www.bankrate.com/finance/checking/checking-fees-record-highs-in-2012.aspx#slide=2.

11. Claes Bell, *Abracadabra: Free Checking Disappears!*, BANKRATE.COM (Sept. 26, 2011), http://www.bankrate.com/finance/checking/abracadabra-free-checking-disappears.aspx. Fees for ATM withdrawals, overdrafts, and other bank fees have risen as well.

12. *See* Richard Barrington, *Bank Fees Survey EOY 2012: Online Banks Resist Raising Fees*, MONEYRATES.COM (Feb. 18, 2013), http://www.money-rates.com/research-center/bank-fees/; Becky Yerak, *Checking, ATM Fees More Common, More Costly*, CHI. TRIBUNE, Aug. 13, 2012, http://articles.chicagotribune.com/2012-08-13/business/chi-checking-atm-fees-rise-in-amount-become-more-common-20120813_1_atm-fees-fees-and-balance-requirements-credit-un ions.

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

(such as by closing bank branches and laying off workers[14]) and shedding unprofitable customers. For example, Bank of America's CEO stated that the bank will focus on the top 20% of its most profitable customers and get rid of the unprofitable ones.[15] JPMorgan Chase estimated that new regulations on overdraft programs and price controls on debit card interchange fees made unprofitable 70% of customers with less than $100,000 in deposits, which required the bank to either raise fees, reduce costs and services, or shed unprofitable customers.[16] Just as access to banks shrank, credit cards became less available to many consumers as a result of the Credit CARD Act of 2009. The Act imposed new rules that directly restricted access to credit cards for consumers under the age of twenty-one and indirectly restricted access for many lower-income consumers.

Prepaid cards are also becoming more mainstream for middle-class families. "Closed loop" prepaid cards, such as gift or reloadable cards that cardholders can use with only one merchant (such as Target, Starbucks, or Amazon.com) or with a group of related merchants (such as Old Navy, Gap, and Banana Republic), are a staple of middle-class shopping habits. General-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 prove useful for caregivers, such as a child's nanny or an elderly parent's home care provider. Rather than risk misuse or require a caretaker to account for usage after the fact, a family member can

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14. *See* Press Release, IBC Bank, 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,* ABC NEWS (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) [hereinafter Bell, *Prepaid Debit*], http://www.bankrate.com/financing/banking/prepaid-debit-oasis-for-unbanked/.

16. *See* Dan Fitzpatrick & David Enrich, *Big Bank Weighs Fee Revamp*, WALL ST. J., Mar. 1, 2012, http://online.wsj.com/article/SB10001424052970204571404577253742237347180.html.

17. In fact, prepaid card issuers developed special prepaid card products that target parents of college students by featuring built-in parental controls. *See* JAVELIN STRATEGY & RESEARCH, *supra* note 5, 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.

provide a caretaker with a prepaid card instead of cash, a credit card, or a debit card. Prepaid cards enable the caregiver to access funds with greater security and accountability.

As usage of prepaid cards grows, so does regulatory scrutiny. In large part this scrutiny focuses 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. There is also no evidence that prepaid card customers systematically fail to understand the fees and other costs of prepaid cards in comparison to the costs of relevant alternatives. Nor is there any other evidence of a competitive market failure (such as monopoly power) that supports immediate, intrusive government regulation. Instead, as the market grows, it appears robustly competitive with minimal barriers to entry and several major entrants. The largest barrier to competition—regulation itself, namely, the Durbin Amendment—hampers 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' 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 when deciding between either monthly fee plans on one hand or per-transaction fee plans on the other. Indeed, as a testament to the competitiveness of the prepaid card market, even as the cost of bank accounts rose, the cost of prepaid cards fell substantially.

The analysis and conclusions presented here are tentative and subject to revision. The prepaid card market is growing and evolving rapidly. The market experienced substantial changes in entry, innovation, and customer demographics in recent years. Moreover, there is little academic study of the market. The studies discussed here are of varying degrees of scientific validity and rigor. Many are funded or written either by industry or consumer activist organizations and thus may suffer from bias. This Article parses through these various studies, assesses their credibility, draws a coherent picture of the market today, and makes predictions about where the prepaid card market is headed.

This Article 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 cardholders can use only with either the designated merchant or a group of affiliated merchants. Open loop cards include payroll cards and general-purpose cards that cardholders can use 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 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% per year in volume and 22.9% in number of charges. In comparison, debit card annual growth in volume was 14.8% and credit card volume declined 0.2%.[22] Meanwhile, the year-to-year annual percentage growth of dollars loaded on prepaid cards rose 40% or more each year since 2008.[23] Although prepaid card use declined slightly from 2008 to 2009, debit and credit card use declined more dramatically. Prepaid card transactions increased as a percentage of electronic transactions during

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18. CAROL R. VAN CLEEF ET AL., EMERGING TRENDS IN STORED VALUE AND PREPAID CARDS 3 (Bryan Cave ed. 2005), *available at* http://www.mtraweb.org/conferences/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 (2011), *available at* http://bretton-woods.com/media/51f57d9869e66aa1ffff8159ffffd502.pdf.

21. *What's the Deal with Prepaid Cards? How General Purpose Reloadable Cards (GPR) Are Growing and What's Next*, CONSUMER FIN. PROTECTION BUREAU, http://www.consumerfinance.gov/notice%20-and-comment/whats-the-deal%20-with-prepaid-cards/ (last visited June 3, 2013) [hereinafter *What's the Deal with Prepaid Cards?*].

22. FED. RESERVE BANK SERVS., THE 2010 FEDERAL RESERVE PAYMENTS STUDY: NONCASH PAYMENT TRENDS IN THE UNITED STATES: 2006–2009, at 17 (2011), *available at* http://www.frbservices.org/files/communications/pdf/press/2010_payments_study.pdf.

23. *What's the Deal with Prepaid Cards?*, *supra* note 21.

that period.[24] Since 2009, prepaid card usage grew dramatically. Some estimate that by 2014 the total annual volume loaded onto general-purpose reloadable (GPR) 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% to 66% of consumers), credit card ownership fell 7 percentage points (from 74% to 67%), checking account ownership dropped 4 percentage points (from 92% to 88%), and personal savings account ownership fell 10 percentage points (from 72% to 62% of consumers).[26] Javelin found that the only major consumer financial product to grow in ownership during that period was prepaid cards. During that time, consumer use of prepaid cards rose by two percentage points to 13%.[27] 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 that resulted from recently enacted regulation.

As prepaid card usage grows, its user base is broadening as well.[28] 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. Many consumers use GPR cards infrequently and for only a short amount of time before discarding them, while others use prepaid cards heavily and repeatedly, apparently as a substitute for a traditional checking account.[29] On average, a card is active for six months before a cardholder discards it, but this metric shows variation by retail channel.[30] Cards purchased at retail outlets are typically 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.[31] Most cards distributed through retailers are used for five or fewer purchases, and only 11% are used more than fifty times. Cards marketed through web distributors are used more heavily.[32] According to the Philadelphia Federal Reserve study, more than a quarter of GPR cards are used for fifty or more

24. *See* Kevin Foster et al., *The 2009 Survey of Consumer Payment Choice* 17 (Fed. Reserve Bank of Bos., Public Policy Discussion Paper No. 11-1, 2011).

25. *See* Electronic Fund Transfers (Regulation E), 77 Fed. Reg. 30923 (proposed May 24, 2012) (to be codified at 12 C.F.R. pt. 1005) (citing report by Mercator Advisory Group).

26. JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 8 fig.1.

27. *Id.*

28. Bell, *Prepaid Debit*, *supra* note 15.

29. *See* Stephanie M. Wilshusen et al., *Consumers' Use of Prepaid Cards: A Transaction-Based Analysis* 20 (Fed. Reserve Bank of Phila., Payment Cards Discussion Paper, 2012).

30. *Id.* at 18.

31. *Id.* at 18–19.

32. *Id.* at 20.

purchase transactions.[33] Purchase volumes are similarly varied by distribution channel, as 37% of cards distributed through the Internet have purchase volumes of more than $1,000 compared to less than 20% of those distributed through retailers.[34] Those who acquire cards via the Internet typically reload the cards many more times than those who acquire them from retailers.[35]

Cardholders can typically use prepaid cards to make purchases with either a signature or personal identification number (PIN), by withdrawing cash at automated teller machines (ATMs), or by requesting cash back with purchases at grocery stores and drug stores. Consumers can check their balances online, over the phone, or at an ATM.[36] Prepaid cards also generally offer deposit insurance and fraud protection if consumers follow certain procedures.[37] 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—some offer interest rates higher than prevailing bank rates.[38] Some prepaid card customers express a desire for more cards that offer savings, direct deposit, and credit building features.[39] Others, on the other hand, prefer prepaid cards to credit or debit cards because of prepaid cards' anonymity, the fact that prepaid cards are not integrated into a credit reporting system, and because they can obtain prepaid cards without an in-depth identification or credit check.[40]

Overall, prepaid card users appear satisfied with the product. According to a National Urban League survey focused on African-American consumers, 67% of current reloadable prepaid card owners rate their perception of the cards as either positive or very positive

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33. *Id.*

34. *Id.* at 21.

35. *Id.*

36. 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.

37. There is some uncertainty, however, as to how extensive and uniform these protections are. *See* discussion *infra* notes 255–60 and accompanying text.

38. For example, NetSpend 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* 15–16 (Ctr. for Fin. Servs. Innovation, Working Paper No. 9, 2009). News reports indicate that this savings feature is popular with NetSpend's customers. *See* Fields & Jackson-Randall, *supra* note 1.

39. *See* PEW HEALTH GRP., KEY FOCUS GROUP FINDINGS ON PREPAID DEBIT CARDS 3 (2011), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/FSP_12014%20Pew%20Debit Cards_R10A-4-5-12.pdf.

40. *Id.* at 5.

overall, and only 7% have a negative opinion.[41] Even among former users of prepaid cards, only 15% had a negative opinion.[42] Research by the Aite Group also found very high levels of satisfaction with prepaid cards—73% of those surveyed responded that they were "very" or "extremely" satisfied.[43]

B. *Industry Structure: How Prepaid Cards Work*

The prepaid card network operates similarly to other types of electronic payment systems but with a few differences.[44] 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 cards.[45] Because many prepaid card users do not have traditional bank accounts, industry members devised alternative mechanisms for distributing 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.[46] The "program manager" provides the retail interface for the card and handles the marketing and day-to-day operations of the card program.[47] "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.[48]

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. These retail-level distributors act as agents for the loading networks and provide locations

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41. *See* LINKAGE RESEARCH & CONSULTING, INC., AFRICAN AMERICAN CONSUMERS & RELOADABLE PREPAID CARDS: PREPAID CARDS HELP AFRICAN AMERICANS CONTROL SPENDING, AVOID OVERDRAFT AND ACCESS THE FINANCIAL MAINSTREAM 2 (2011), *available at* http://www.nbpca.com/en/Research-and-Publications/Research-Articles/NUL-Survey-Linkage-Research.aspx. As discussed below, this relative satisfaction with prepaid cards may also reflect a high level of dissatisfaction with alternatives.

42. *Id.*

43. MADELINE K. AUFSEESER, AITE GRP., GPR CARDHOLDERS: WHO ARE THEY REALLY? DISPELLING THE MYTHS 7 (2012), *available at* http://www.nbpca.org/~/media/E6E6F720492F4E42804FED2A795D3B5A.ashx.

44. *See* CTR. FOR FIN. SERVS. INNOVATION, THE NONPROFIT'S GUIDE TO PREPAID CARDS 14 (2010), *available at* http://cfsinnovation.com/system/files/CFSI%20Nonprofit%20Guide%20to%20Prepaid.pdf.

45. *Id.* at 9.

46. These include companies such as FIS, FirstData, MT&L, and FSV Payment Systems. *Id.* at 18.

47. These include companies such as Account Now, Green Dot, NetSpend, and RushCard. *Id.*

48. "Loading networks" include brands such as Green Dot, Western Union, MoneyGram, Visa ReadyLink, and MasterCard rePower. *Id.*

where consumers can load or reload their cards. NetSpend, one of the largest networks, has over 100,000 loading locations in retail stores.[49] Consumers can also acquire, load, and reload their cards online. According to Javelin Strategy & Research, 48% of prepaid card users reload online, more than any other way.[50] Check cashers, such as ACE Cash Express, which traditionally competed with prepaid cards, are now becoming outlets for 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. The large number of players in the system and the important role played by nonfinancial institutions raises the risk of greater insolvency and security breaches for prepaid cards than those presented by other types of payment cards.[51] For example, the system of reloading cards at tens of thousands of nonfinancial retailers raises special problems of security, fraud, and misuse.

Prepaid cards generate several different revenue streams, including retail fees, card fees, and interchange fees, but those revenue streams are divided amongst 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 is 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% of the average length of a checking account.[52] Thus, the prepaid card companies must recoup fixed costs 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.[53] One reason for low revenues is that

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49. *About NetSpend*, NETSPEND, https://www.netspend.com/about_netspend (last visited May 27, 2013).

50. JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 29 fig.14. Forty-four percent reported reloading at a merchant or retailer, 27% at a money services provider, 23% at a bank branch, and 17% at an ATM. *Id.*

51. *See* Philip Keitel, *Insolvency Risk in the Network-Branded Prepaid-Card Value Chain* 3 (Fed. Reserve Bank of Phila., Discussion Paper, 2011), *available at* http://www.phil.frb.org/consumer-credit-and-payments/payment-cards-center/publications/discussion-papers/2011/D-2011-September-NBPCA-Keitel.pdf.

52. Wilshusen et al., *supra* note 29, at 18.

53. *Id.* at 5.

customers tend to be relatively young and lower income, generating a lower volume and dollar amount of transactions than debit or credit card users.

C. *Prepaid Card Fees*

The most common criticism of prepaid cards concerns fees—fees for issuance, activation, reloading, ATM usage, and customer service.[54] A study by Pew Charitable Trusts of fifty-two prepaid card programs in 2011 found that most cards have seven to fifteen fees and that disclosure of fees is not uniform.[55] 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 declined over time as a result of competition and consumer choice. *Consumer Reports* found in a recent survey that although activation fees used were standard fixtures in the past, only about half of the sixteen most popular cards charge an activation fee today. In addition, Pew's study found, for example, that when companies charge fees (other than activation and monthly fees, when those fees are charged), the fees are mostly small, less than $3 and frequently $1 or less.[56] Moreover, some large card issuers, such as NetSpend and Western Union, that previously charged activation fees no longer do so.[57] Those that continue to charge activation fees (such as the RushCard) substantially lowered them.[58] AccountNow pays a rebate to those who activate direct deposit on their cards.[59] The Bluebird prepaid card, co-branded between American Express and Walmart in October 2012, has no annual fee, monthly fee, or activation fee.[60]

The most common fee is a monthly maintenance fee, although these

54. *See, e.g.*, CONSUMER REPORTS, PREPAIDCARDS: LOADED WITH FEES, WEAK ON PROTECTIONS 4 (2012), *available at* http://www.consumersunion.org/pdf/Prepaid_Cards_Report_2012.pdf.

55. PEW CHARITABLE TRUSTS, LOADED WITH UNCERTAINTY: ARE PREPAID CARDS A SMART ALTERNATIVE TO CHECKING ACCOUNTS? 2 (2012), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_prepaid_report.pdf.

56. *Id.* at 8. For example, although nine card programs charge a fee of $1 or $1.25 when a point-of-sale (POS) transaction is declined (depending on whether it is signature or PIN debit that is declined), forty-three do not. *Id.* at 2–3.

57. *See* CONSUMER REPORTS, *supra* note 54, at 5.

58. *Id.*

59. *Id.*

60. *See* Robin Sidel & Andrew R. Johnson, *Prepaid Enters Mainstream*, WALL ST. J., Oct. 9, 2012, http://online.wsj.com/article/SB10000872396390444897304578044313831625492.html.

fees are falling. 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 each month.[61] 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.[62] 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. Some cards, however, allow cardholders to nominally overdraft on their accounts in some circumstances without charging any fee for doing so.[63]

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.[64] Pew found that fifty-one of the fifty-two cards it examined allowed consumers to avoid loading fees by using direct deposit. To acquire cash without paying ATM fees, consumers can opt for cash back when making a POS PIN purchase.[65] Although most cards permit customers to view their account balances and some form of transaction history online for free, there is usually a charge associated with obtaining a paper statement.[66]

Wilshusen et al. found that the distribution of fees varies according to the distribution channel through which a consumer obtains a card. As noted, the distribution channel appears to indicate 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% of the fees charged, ATM withdrawal fees comprise 22%, and transaction and other fees (such as those for POS transactions, balance inquiries, obtaining a paper statement, or calling customer service) are 26%.[67] For retail GPR cards,

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61. CONSUMER REPORTS, *supra* note 54, at 6.

62. *Id.*

63. According to the Pew study, 65% of cards disclosed that overdraft was not allowed and a fee was not allowed. Only 10% explicitly stated that there was a fee for overdrawing and the median fee was $15. *See* PEW CHARITABLE TRUSTS, *supra* note 55, at 21.

64. CARD HUB, PREPAID CARDS REPORT—2011 (2011), *available* at http://www.cardhub.com/edu/prepaid-cards-report-2011/.

65. PEW CHARITABLE TRUSTS, *supra* note 55, at 9.

66. *Id.*

67. Wilshusen et al., *supra* note 29, at 31–32, 60 fig. 5.2.

by contrast, maintenance and origination fees comprise only 28% of fees, ATM withdrawal fees are 17%, and the majority of fees (55%) are for transactions and other fees.[68] These different fee distributions are consistent with the suggested pattern of use by consumers of GPR cards for differing purposes.[69] 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.[70]

Fees are falling in response to competitive pressures as the market grows and scale economies evolve. 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% in 2008 to 45.6% in 2009.[71] This increase in the perceived affordability of prepaid cards while bank accounts became more expensive may explain why prepaid card usage rose relative to debit card usage during that time.[72] According to NetSpend's public reports, the percentage of customers electing to use direct deposit is growing as well, rising from 34% in 2010 to 41% in 2011. This increase signals that consumers are increasingly using their prepaid cards like bank accounts. The increase also means that more consumers are taking advantage of the lower costs of cards that feature direct deposit.[73]

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 that it pays to third parties, particularly the third-party bank that issues Green Dot cards.[74] Entry by large banks may lower costs as well. For example, JPMorgan 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

68. *Id.* at 32–33, 61 fig. 5.3.

69. Payroll cards exhibit different patterns of fee activity: over half (54%) of the fees generated by payroll cards are for ATM withdrawals and just 10% are maintenance fees. *Id.* at 31–32, 59 fig. 5.1.

70. *Id.* at 32. Pew similarly found an average ATM fee of $2.25. PEW CHARITABLE TRUSTS, *supra* note 55, at 8. 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 the customer's bank. *See* Bell, *Checking Fees Rise*, *supra* note 10.

71. Foster et al., *supra* note 24, at 30.

72. *Id.* at 30–31.

73. Press Release, NetSpend Holdings, Inc., NetSpend Holdings, Inc. Reports Fourth Quarter Financial Results (Feb. 16, 2012), http://investor.netspend.com/releasedetail.cfm?releaseid=649475.

74. *Green Dot Buying Small Utah Bank*, BLOOMBERG BUSINESSWEEK (Nov. 23, 2011, 4:43 PM), http://www.businessweek.com/ap/financialnews/D9R6MI0G0.htm.

remote deposits by cellphone.[75]

II. REGULATORY FRAMEWORK

As prepaid card usage grows, regulatory scrutiny increases 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" impose new regulations on prepaid card terms and disclosures in the name of safety and soundness or consumer protection.

A. *Direct Regulation of Prepaid Cards*

The Electronic Fund Transfer Act (EFTA) and the implementing regulation, Regulation E, regulate at the federal level certain prepaid cards. For example, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act) amended the EFTA in three ways with regard to prepaid cards. First, the CARD Act added new disclosure requirements regarding fees for store gift cards and general-use prepaid cards that are issued for personal and family use. Second, the CARD Act limited the circumstances under which a card may feature an expiration date.[76] Third, the Federal Reserve Board acted under Regulation E and 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, by placing limits on expiration dates and fees, requiring certain disclosures, and mandating cash redemption of unused card balances. California law, for example, prohibits gift cards from expiring, limits dormancy fees, and requires that the cards are redeemable for cash.[77] Further legislation is under consideration in several states and Puerto Rico now as well.[78] These state laws are considered more protective of consumers than federal law. Under the federal EFTA, state laws are preserved as long as they are not inconsistent with the EFTA.

Congress is also considering new legislation to regulate prepaid cards. Legislation introduced by Senator Robert Menendez (D-N.J.)

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75. *See Chase Liquid Prepaid Card*, CARDHUB.COM, http://www.cardhub.com/d/liquid-prepaid-card-684c (last visited July 18, 2013).

76. Requirements for Gift Cards and Gift Certificates, 12 C.F.R. § 1005.20(a) (2012).

77. *See* CAL. CIV. CODE § 1749.5 (2013).

78. *See* H.B. 4451, 98th Gen. Assemb. (Ill. 2012), *available at* http://www.ilga.gov/legislation/BillStatus.asp?DocNum=4451&GAID=11&DocTypeID=HB&LegID=63812&SessionID=84&SpecSess=&Session=&GA=98 (Illinois); *Prepaid Debit Cards, Fees and Impending Regulations*, CREDITKARMA (June 22, 2012), http://blog.creditkarma.com/banking/prepaid-debit-cards-fees-and-impending-regulations (New Jersey); *Puerto Rico Legislature Passes Fee Restrictions for Prepaid, Industry Urged to Contact Gov. Immediately*, PAYBEFORE.COM (Aug. 16, 2012), http://www.paybefore.com/aboutus/default. aspx?id=25438 (Puerto Rico).

would impose new substantive and disclosure requirements on prepaid card products.[79] The legislation would, among other provisions, require "pass-through" coverage to consumers of FDIC deposit insurance for prepaid card accounts.[80] 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.[81] In addition, the legislation would prohibit prepaid card companies from imposing fees for balance inquiries, customer service inquiries, dormancy, account closing, or overdrafts.[82] The legislation would permit reload fees only if the financial institution provided "a reasonable alternate method for adding value" without a fee.[83] The overall effect of the legislation would dramatically affect the market and consumers: it essentially would ban cards priced on a per-transaction basis, and force 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 negatively affect consumers who prefer cards priced on a per-transaction basis because they use their cards lightly and for specific reasons.[84] The bill would also require the Consumer Financial Protection Bureau (CFPB) to issue a new rule providing a standardized disclosure format for prepaid card fees and prices.[85]

Additionally, the CFPB will have both the authority to regulate the offering and provision of "consumer financial products," including prepaid cards, and the authority to issue any rules that the CFPB determines to be "necessary or appropriate" to carry out the objectives of federal consumer financial protection laws.[86] With respect to prepaid cards, the CFPB inherited the Federal Reserve's authority under Regulation E to regulate prepaid cards. In addition, the CFPB is responsible for monitoring developments in the prepaid market and

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79. *See* Prepaid Card Consumer Protection Act of 2011, S. 2030, 113th Cong (2011).

80. *Id.* 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 pools all of its customers' funds in a single account. Nevertheless, the FDIC established procedures that banks can follow to provide "pass-through" insurance in the name of the individual cardholder instead of 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* notes 250–56 and accompanying text.

81. S. 2030.

82. *Id.*

83. *Id.*

84. *See infra* notes 245–47 and accompanying text (noting that consumers overwhelmingly choose correctly between the two different card pricing schemes).

85. S. 2030 § 3(e)(3).

86. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1958 (2010) (codified at 15 U.S.C. §§ 1002(15)(A)(v), 1022).

determining whether to propose additional consumer protections.

Pursuant to this authority, the CFPB issued an Announcement of Proposed Rulemaking and held a field hearing on prepaid card regulation.[87] The CFPB's announcement asks for comments on a variety of issues: the degree to which Regulation E should cover general-purpose prepaid cards; how to regulate prepaid cards to promote competition and consumer choice; and whether to mandate special disclosures for cards that do not offer pass-through of FDIC insurance.[88] In addition, the CFPB asks for comments on various features of prepaid cards, such as overdraft protection, savings accounts, and the ability to build credit by reporting prepaid card bill payments to credit reporting agencies.[89]

New regulations imposed on bank overdraft fees beginning in 2009 are indirectly relevant to understanding the market for prepaid cards. By limiting overdraft fees, these regulations reduce access to free checking and consequently increase the number of unbanked consumers. According to Evans, Litan, and Schmalensee, "within days" of the Fed's announcement of its new rules, banks started scaling back access to free checking, imposing new fees, and eliminating services for consumers.[90] The number of accounts eligible for free checking fell 11 percentage points—from 76% in 2009 to 65% in 2010—a figure that translates to approximately twenty million accounts.[91] The combination of price controls on debit card interchange fees and limits on access to overdraft protection dramatically reduced access to free checking, swelled the ranks of the unbanked, and in turn, increased demand for prepaid cards.

B. *The Durbin Amendment*

Recent regulations of debit and credit cards indirectly promoted their substitution with prepaid cards. The Durbin Amendment to the Dodd-Frank financial reform legislation places price controls on debit card interchange fees, and requires that the fees remain "reasonable and proportional" to the card issuer's marginal cost.[92] Effective October 1, 2011, "reasonable and proportional" fees are not to exceed the sum of twenty-one cents and "5 basis points multiplied by the value of the

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87. Electronic Fund Transfers (Regulation E), 77 Fed. Reg. 30,923 (proposed May 24, 2012) (to be codified at 12 C.F.R. pt. 1005).

88. *Id.*

89. *Id.*

90. 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* 31 (Feb. 22, 2011) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1769887.

91. *Id.*

92. 15 U.S.C. § 1693o-2(a)(2) (2011).

transaction."[93] This cut in the interchange fee rate is estimated to cost banks over $6 billion in revenue annually. It prompted banks to recover 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 who are no longer profitable.[94] These new higher fees will eventually push an estimated 5% of consumers out of the mainstream banking system[95] and increase the number of unbanked consumers by 1 million.[96] The Durbin Amendment will likely adversely impact younger, less educated, and lower-income consumers the most, especially those with lower credit scores. They will find bank accounts more expensive, less available, and of lower quality (such as fewer services, fewer branches, and shorter and less convenient banking hours and locations).[97] Now, some banks offer prepaid cards to consumers when they are rejected for a checking account because they no longer qualify in the current economic and regulatory environment.[98] Even if merchants pass on to consumers the savings from decreased debit interchange fees, low-income consumers who either struggle to meet minimum balance requirements or who have poor credit will likely switch to prepaid cards to avoid these new fees.[99]

The average interchange fee on prepaid cards is approximately forty cents per transaction.[100] Interchange fees are an important revenue source for prepaid cards: during the first quarter of 2011, interchange revenue comprised 32% of operating revenue at Green Dot and 24% at NetSpend.[101] Wilshusen et al. find that interchange fees comprise about

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93. Debit Card Interchange Fees and Routing, 12 C.F.R. § 235.3(b) (2012).

94. Tim Chen, *What the Durbin Amendment Means for You*, U.S. NEWS (July 12, 2011), http://money.usnews.com/money/blogs/my-money/2011/07/12/what-the-durbin-amendment-me ans-for-you. For example, many debit card issuers subject to the price controls eliminate rewards on debit cards but preserve them for credit and prepaid cards. About half of prepaid card users say that the availability of rewards on prepaid cards increases the likelihood that they would use them. *See Prepaid Cards Lure Underbanked and Gen Y Customers*, JAVELIN STRATEGY & RESEARCH (Apr. 11, 2012), https://www.javelinstrategy.com/news/1326/92/Prepaid-Cards-Lure-Underbanked-and-Gen-Y-Consumers/ d,pressRoomDetail.

95. BRETTON WOODS, INC., *supra* note 20, at 14.

96. Evans et al., *supra* note 90, at 4.

97. *See* Fumiko Hayashi & Joanna Stavins, *Effects of Credit Scores on Consumer Payment Choice* 1, 3 (Fed. Reserve Bank of Bos. Public Policy Discussion Paper No. 12-1, 2012).

98. Elizabeth Ody, *Prepaid Card Use Up 18% as Consumers Drop Debit: Study*, BLOOMBERG BUSINESSWEEK (Apr. 11, 2012, 10:07 AM), http://www.businessweek.com/news/2012-04-11/prepaid-card-use-up-18-percent-as-consumers-drop-debit-study.

99. Chen, *supra* note 94.

100. BD. OF GOVERNORS OF THE FED. RESERVE SYS., 2009 INTERCHANGE REVENUE, COVERED ISSUER COST, AND COVERED ISSUER AND MERCHANT FRAUD LOSS RELATED TO DEBIT CARD TRANSACTIONS 8 (2011), *available at* http://www.federalreserve.gov/paymentsystems/files/debitfees _costs.pdf.

101. Jennifer Tescher, *Durbin's Unintended Consequences for the Underbanked*, AM.

20% of issuer revenue for GPR cards and about half of revenue for payroll cards.[102] Increased marketing of prepaid cards in an effort to switch debit card users to prepaid cards or to attract new customers may offset 20%–50% of the losses in debit interchange revenue.[103]

Prepaid cards, however, are not entirely free from the Durbin Amendment's reach. For the purposes of 15 U.S.C. § 1693o-2, "debit card" is defined to include general-use prepaid cards, as set forth in 15 U.S.C. § 1693l-1(a)(2)(A).[104] "Small issuers,"[105] those with assets below $10 billion, are exempt.[106] 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 prevent 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. In particular, large banks cannot offer online bill pay, recurring ACH debit (such as to pay utility bills), or funds transfer among different accounts (such as the transfer of funds from a prepaid card to an interest-bearing savings account). If large banks offer these

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BANKER (July 26, 2011, 6:06 PM), http://www.americanbanker.com/bankthink/Durbin-debit-interchange-prepaid-underbanked-1040610-1.html.

102. Wilshusen et al., *supra* note 29, at 6.

103. *Recouping Lost Debit Interchange Fees with Prepaid Cards*, AITE GROUP (Mar. 21, 2011), http://www.aitegroup.com/Reports/ReportDetail.aspx?recordItemID=770.

104. 15 U.S.C.A. § 1693o-2(c)(2) defines the term "debit card" as follows:

> (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 1693l-1(a)(2)(A) of this title; and
> (C) does not include paper checks.

Id. 15 U.S.C. § 1693l-1(a)(2)(A) defines "general-use prepaid card" as follows:

> [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.

Id.

105. A "small issuer" includes "any issuer that, together with its affiliates, has assets of less than $10,000,000,000." 15 U.S.C. § 1693o-2(a)(6)(A) (2012).

106. *Id.* § 1693o-2(a)(6)(A)–(B).

functions, they are subject to the Durbin Amendment's price controls on interchange fees. Thus, in addition to swelling the Durbin Amendment's ranks of the underbanked, it could also stifle the evolution of prepaid cards into low-cost bank account substitutes 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 large banks issued two of the three least expensive cards.[107] 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 10,500 branches; free customer service with a live agent; free reloading through ATMs, branches, or mobile banking; and even free paper bank statements.[108] Chase designed the Liquid card as an alternative to a traditional checking account. As one review notes, however, "[T]he Liquid card doesn't [offer] much in the way of an automatic online bill pay option."[109] What the review failed to note, however, is that Chase is unable to provide Liquid with an online bill pay feature and other similar functionalities because these features 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 can thus offer bill pay without triggering the Durbin Amendment's interchange price controls.[110]

Other exemptions from the Durbin Amendment's reach include reloadable prepaid cards that are either government-issued or meet the criteria set forth in § 1693o-2(a)(7)(A)(ii), namely, that consumers cannot use the cards to access funds held in a separate account, such as a bank account (i.e., they are essentially not debit cards).[111]

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107. The two cards were U.S. Bank Convenient Cash Card ($39 per year) and ATIRAreload Card ($54 per year). *Out of 82 Prepaid Debit Cards, Find the One for You*, NERDWALLET, http://www.nerdwallet.com/prepaid (last visited July 23, 2013).

108. *Id.*

109. Jill Krasny & Zachry Floro, *Chase's New Prepaid Card Actually Looks Like a Decent Product*, BUSINESSINSIDER (July 10, 2012, 1:24 PM), http://www.businessinsider.com/reviewing-chases-new-prepaid-card-chase-liquid-2012-7.

110. *See* Matt Townsend, *Wal-Mart Offers Bank Account Option with American Express*, BLOOMBERG (Oct. 9, 2012, 12:00 AM), http://www.bloomberg.com/news/2012-10-09/wal-mart-offers-bank-account-option-with-american-express.html.

111. Exempt reloadable prepaid cards include those that are government-issued or in compliance with a five-factor test. 15 U.S.C. § 1693o-2(a)(7)(A) (2012). 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;

Notwithstanding these exemptions, the Durbin Amendment became effective July 21, 2011[112] for interchange transaction fees charged with respect to government-issued prepaid cards, and for § 1693o-2(a)(7)(A)(ii)-compliant prepaid cards that subject 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."[113]

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 carries fees, and in theory these products compete against one another. The primary differences are 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 distinguished prepaid cards from debit and credit cards was the user base, not the basic product. Prepaid card users traditionally are unbanked as well as lower-income, less educated, less financially sophisticated, and able to access 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 cashing 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 increases, fees fall and functionality rises. Now, some consumers choose prepaid cards

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> (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.

Id. § 1693o-2(a)(7)(A)(ii).

112. The exception set forth in 15 U.S.C. § 1693o-2(a)(7)(B) applies "after the end of the 1-year period beginning on the effective date provided in paragraph (9)." *Id.* § 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 C.F.R. 235.5(d) (2012).

113. 15 U.S.C. § 1693o-2(a)(7)(B)(i)–(ii) (2012).

voluntarily over debit and credit cards.

A. *Profile of Prepaid Card Customers*

There is 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, suffering from tarnished credit, or otherwise excluded from the mainstream financial system. But as GPR prepaid cards are becoming more popular, they are also becoming more mainstream demographically and are prospering in certain middle-class niches.

The unintended consequences of recent regulatory interventions are particularly important in promoting adoption of prepaid cards by two groups. The first group is low-income consumers who are driven out of the banking system by new fees and other costs attributable to the Durbin Amendment, new restrictions on overdraft protection, and the CARD Act.[114] 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),[115] also find 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 twenty-one.[116] At the same time, the virtual disappearance of check writing by younger consumers further promotes a reliance on electronic payments. Finally, unique product attributes such as parental control features open up prepaid cards to a new market range, such as students 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.[117] They found that prepaid card users were young: 82% were under the age of forty-five.[118] They found that while most cardholders carried modest balances and used their cards primarily to pay bills and make POS transactions, some appeared to use

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114. JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 8–10.

115. For example, according to one study, 21% of Gen Y consumers do not have a checking account, compared to the national average of 12%. *Id.* at 25.

116. *Id.* at 8.

117. SHERRIE L.W. RHINE ET AL., THE CTR. FOR FIN. SERVS. INNOVATION, CARDHOLDER USE OF GENERAL SPENDING PREPAID CARDS: A CLOSER LOOK AT THE MARKET 5, 18 (2007), *available at* http://www.cfsinnovation.com/system/files/imported/managed_documents/general_spending_prepaid_cards.pdf.

118. *Id.* at 21; *see also* Ronald J. Mann, *Adopting, Using, and Discarding Paper and Electronic Payment Instruments: Variation by Age and Race* 14–15 (Fed. Reserve Bank of Bos. Consumer Payments Research Ctr. Pub. Policy Discussion Paper No. 11-2, 2011) (finding prepaid card users to be younger on average than debit or credit card users), *available at* http://www.bostonfed.org/economic/ppdp/2011/ ppdp1102.pdf.

them as a substitute for a traditional bank account.[119] For example, although most users reloaded their cards infrequently, 16% loaded them twice or more a month.[120] In addition, those who reloaded more frequently loaded larger value loads on average, which suggested that they used their cards as a substitute for a traditional bank account.[121]

For withdrawals, Rhine et al. found that the average value of a POS transaction was $39.48, and funds withdrawn from ATMs averaged $41.35 per transaction.[122] The average cardholder maintained a monthly utilization rate of 92%, which indicated 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 21% were withdrawn from ATMs, suggesting that the primary usage was for electronic payments rather than cash access.[123] 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.[124] 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.[125] Forty-five percent of cardholders did not access their accounts through an ATM during the month, and 28% did so less than once per month.[126] As with deposits, those who accessed their accounts more than twice per month also tended to make larger ATM withdrawals.[127] For POS transactions, only 6% of those surveyed did not use their cards at all during a month, and 27% did so less than once per month.[128] However, 14% made POS transactions three to five times per month and 24% did so more than five times per month.[129]

In 2009, Gordon, Romich, and Waithaka conducted in-depth focus group interviews with 12 AccountNow prepaid card customers and 10 NetSpend prepaid card customers.[130] 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.[131] They also found a substantial income range: The incomes of the surveyed AccountNow customers ranged from $15,000 to

119. RHINE ET AL., *supra* note 117, at 22.
120. *Id.* at 23.
121. *Id.*
122. *Id.* at 22.
123. *Id.*
124. *Id.* at 27.
125. *Id.* at 28.
126. *Id.* at 24.
127. *Id.*
128. *Id.* at 25.
129. *Id.*
130. Gordon, Romich & Waithaka, *supra* note 38, at 2, 9.
131. *Id.* at 10.

$160,000 and the NetSpend customers' incomes ranged from $12,000 to $55,000.[132] Additionally, the surveyed prepaid card users were significantly less likely than the general population to own a home: only 25% of the AccountNow customers were homeowners and none of the NetSpend customers owned their homes.[133] Debt levels were significant relative to income levels for participants in the survey: fewer than 20% were debt-free; median debt levels were $10,000 and $8,250 respectively for AccountNow and NetSpend customers; and AccountNow customers' debt ranged up to $45,000 and NetSpend customers' debt ranged up to $175,000.[134] Unpaid bills, especially unpaid utility bills and unpaid bank fees, constituted the main source of debt for prepaid card users.[135] Over three-quarters of both AccountNow and NetSpend customers reported unpaid utility bills and bank fees.[136] These unpaid bills often led to the termination of customers' accounts. Credit card debt and unpaid medical bills accounted for the bulk of the total amount of debt in dollar terms.[137] Additionally, most of NetSpend's customers carried small balances and used their cards for small transactions.[138] The 2009 survey also found that the prepaid card customers used their cards to pay two to three bills per month (typically phone bills, utility bills, and car payments; they also used their cards for online shopping).[139] The survey shows 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 Aite Group found that one-third of prepaid card users earn more than $45,000 per year, 34% have a college degree or higher, and many maintain both a checking account and a credit card.[140] It found that 40% of customers surveyed used their prepaid cards "most frequently" for POS purchases, 27% used them most frequently for online transactions, and 24% used them most frequently to pay bills.[141] Only 9% reported using their cards most

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132. *Id.* at 11.

133. *Id.*

134. *Id.*

135. *Id.* at 10–11.

136. *Id.* at 11.

137. *Id.* at 10–11. Speaking recently before the Senate Subcommittee on Financial Institutions and Consumer Protection, NetSpend CEO Daniel Henry testified that nearly all NetSpend customers were "working" U.S. citizens, the majority having obtained at least a high school diploma and earning less than $50,000 per year. *Examining Issues in the Prepaid Card Market: Hearing Before the S. Subcomm. on Fin. Inst. & Consumer Prot.*, 112th Cong. 2 (2012) [hereinafter *Prepaid Card Hearing*] (statement of Daniel R. Henry, CEO, NetSpend Holdings, Inc.) (2012).

138. Gordon, Romich & Waithaka, *supra* note 38, at 9.

139. *Id.* at 17.

140. AUFSEESER, *supra* note 43, at 3–4.

141. *Id.* at 9.

frequently at an ATM.[142] The survey also found prepaid cards especially popular among younger consumers, with 43% of prepaid card customers being members of Generation Y at the time of the study.[143]

A 2012 survey by Javelin Strategy & Research of more than 3,000 Americans also found both high usage rates among unbanked and younger consumers and growing mainstream usage.[144] Javelin found young and underbanked consumers almost twice as likely to use prepaid cards as baby boomers.[145] As noted above, Javelin found a substantial drop in the number of consumers with debit and credit cards during that same period the percentage of U.S. adults with prepaid cards rose from 11% to 13%.[146] More than half of underbanked respondents (56%) said they used prepaid debit cards for routine online purchases.[147] Moreover, Javelin found a dramatic rise in the percentage of the population without a checking account. From 2010 to 2011, the percentage increased from 8% to 12%.[148] But Javelin also noted an increasingly mainstream use of prepaid cards: although 17% of those earning under $15,000 per year used prepaid or payroll cards, the second largest group consisted of customers earning $75,000 to $99,000 per year (16%). Additionally, 13% of those earning over $150,000 per year owned prepaid cards in 2011.[149]

Javelin's analysis suggests that a growing number of underbanked consumers use prepaid cards like a traditional bank account.[150] Underbanked prepaid card owners reload their cards more frequently, make larger reloads than other prepaid card owners,[151] and use their cards much more frequently for POS transactions.[152] NetSpend also reports that by 2011, nearly 42% of its cardholders took advantage of the direct deposit feature, up from only 14% in 2007.[153] Also, according to a 2012 news report, Green Dot stated that about half of its customer base uses direct deposit.[154] Wilshusen et al. also found evidence that some consumers use prepaid cards as a substitute for a checking account. They found that some consumers retain prepaid cards for

142. *Id.*
143. *Id.* at 3
144. JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 5–6.
145. *Id.* at 9.
146. *Id.*
147. *Id.* at 20.
148. *Id.* at 9.
149. *Id.*
150. *Id.* at 14.
151. *Id.*
152. *Id.* at 22.
153. NETSPEND, 2011 NETSPEND HOLDINGS FORM 10-K 30 (2012), *available at* http://files.shareholder.com/downloads/ABEA-56BIQV/1684506713x0xS1047469-12-1472/1496623/filing.pdf.
154. *See* Fields & Jackson-Randall, *supra* note 1.

extended periods and use them intensely and primarily for ongoing living expenses, rather than saving and financing large purchases.[155] They also found 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. This pattern, they concluded, "suggests that prepaid cards are used primarily to purchase nondurable goods."[156]

Other evidence points to rapid mainstreaming of prepaid card use. Green Dot states that its median customer income is about $45,000.[157] 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.[158] They found 26% of those with incomes above $100,000 per year owned prepaid cards, whereas only 15% of those with incomes under $25,000 per year or between $25,000 and $50,000 owned prepaid cards.[159] In addition, those who attended post-graduate school were twice as likely to adopt prepaid cards (27%) as those with a high school degree or less (13%).[160] On the other hand, the data collected by Schuh and Stavins are of insufficient granularity to fully explain these patterns of adoption because they include 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 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 aimed at low-income and unbanked consumers remain important for those groups and seem to grow in popularity. But more recent studies and other sources of information indicate prepaid cards are becoming more mainstream and that their demographic base is increasingly reaching toward middle-class consumers.

B. *Prepaid Cards Versus Debit and Credit Cards*

Many consumers prefer debit and credit cards to prepaid cards. Many consumers, however, are unable to obtain or maintain a bank account or to use a credit card responsibly. Others 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

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155. Wilshusen et al., *supra* note 29, at 5–6.
156. *Id.* at 6.
157. *See* Fields & Jackson-Randall, *supra* note 1.
158. Schuh & Stavins, *supra* note 4, at 25 tbl. 1.
159. *Id.*
160. *Id.*

result, some consumers may rationally choose to use prepaid cards instead of a bank account, even if they otherwise could maintain a bank account and carry a debit or credit card. According to a 2008 survey of 2,799 underbanked and unbanked consumers, 55% of unbanked and 18% of underbanked consumers prefer to use a prepaid card to a checking account.[161] And according to another survey, a majority of prepaid card users prefer prepaid cards to credit cards.[162]

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 prove more expensive than prepaid cards for many consumers, especially lower income consumers who either experienced rising bank fees in recent years or those who frequently overdrew their accounts or bounced checks. The cost of prepaid cards may also prove 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.[163] Thus, although checking accounts may prove less expensive for most consumers (those who do not overdraft their accounts), prepaid cards often will prove 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, but that in light of consumer heterogeneity, prepaid cards will prove less expensive for at least some consumers. Accordingly, regulators should preserve the prepaid card choice and neither favor nor disadvantage them by adopting regulatory dictates that

161. CTR. FOR FIN. SERVS. INNOVATION, PREPAID CARD VS. CHECKING ACCOUNT PREFERENCES 1 (2008), http://cfsinnovation.com/system/files/imported/managed_documents/prepaid_oct09_0001.pdf. Of underbanked consumers, 18.3% preferred prepaid cards to checking accounts.

162. AUFSEESER, *supra* note 43, at 6 (noting that 61% of prepaid card users prefer to use prepaid cards compared to only 33% that prefer to use credit cards).

163. BRETTON WOODS, INC., ANALYSIS OF BRANDED GENERAL PURPOSE RELOADABLE PREPAID CARDS: A COMPARATIVE COST ANALYSIS OF PREPAID CARDS, BASIC CHECKING ACCOUNTS AND CHECK CASHING 7 (2012), *available at* http://bretton-woods.com/media/3e145204f3688479ffff832affffd524.pdf.

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.[164] Consumers pay about 21% more in fees for basic checking accounts than they did six years ago. Consumers pay on average about $7.72 per month in a combination of monthly and automated teller machine fees, or over $92 per year.[165] According to a NerdWallet.com survey, unless certain minimum average balance or other similar conditions are met (which is unlikely for those who use prepaid cards), the average monthly fee for traditional checking accounts at the nation's five largest banks ranged from $5 to $12, and these sums do not include additional fees that banks might assess.[166] A 2012 survey by MoneyRates.com found that fees on checking accounts rose across the board from 2011 to 2012, and included increases in the minimum deposit needed to open an account, increases in the minimum balance needed for free checking, and increases in average monthly maintenance fees from $12.08 to $12.26 per month.[167] A study by Barrington Research estimated that the average checking account costs $279 per year for a typical user compared to prepaid cards, which costs $158.[168] According to a survey of prepaid card users by Aite Group, 39% of respondents "strongly agreed" that prepaid cards cost less than checking accounts—more than twice the number of consumers of alternative financial services who still had bank accounts.[169] And 37% strongly agreed that prepaid cards are "better overall" than checking accounts (compared to 15% of users of alternative financial services who still had bank accounts).[170] These studies likely underestimate the value of prepaid cards because they consider only the direct financial costs of bank accounts versus prepaid cards and ignore other costs such as the "shoe leather" costs of reloading cards at over 100,000 retail locations. These costs can prove high, especially for those who lack convenient access to a bank branch

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164. JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 19.

165. *See* Elizabeth Ody, *Regulation Fuels 21% Surge in Checking Fees*, BLOOMBERG (Feb. 29, 2012, 12:54 PM), 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).

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

167. *See* Barrington, *supra* note 12.

168. *See* David Sternman, *This Small IPO Stock Could Jump as Much as 70%*, STREETAUTHORITY.COM (Sept. 15, 2011, 1:00 PM), http://www.streetauthority.com/growth-investing/small-ipo-stock-could-jump-much-70-458578.

169. *The Debanked: A US$1 Billion Prepaid Debit Card Opportunity*, AITE GRP. (Feb. 9, 2012), http://www.aitegroup.com/Reports/ReportDetail.aspx?recordItemID=899.

170. *Id.*

or whose working hours make it inconvenient to bank at a traditional branch.[171]

Pew conducted an in-depth comparison of prepaid and checking accounts and relied on a variety of assumptions about fees and consumer sophistication. Pew concluded that there is "no uniform answer" as to whether prepaid cards are more expensive than checking accounts because the answer depends greatly on how consumers use the alternative products.[172] 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).[173] 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).[174] According to Pew, therefore, it is difficult to generalize whether consumers are better off with prepaid cards or checking accounts. Many basic and inexperienced consumers will likely benefit financially from using a prepaid card instead of a checking account.

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 they can use to maintain a bank account in good standing. According to 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 qualify for free checking.[175] 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 can likely meet.[176]

2. Alienation and Distrust of Banks

A second reason why some consumers prefer to use prepaid cards instead of bank accounts is their alienation from and distrust of the traditional banking system. In fact, many unbanked consumers who use prepaid cards are so-called "debanked" consumers who previously maintained bank accounts but abandoned them either voluntarily or involuntarily due to cost or the inability to manage them responsibly.

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171. *Prepaid Card Hearing*, *supra* note 137, at 3.
172. PEW CHARITABLE TRUSTS, *supra* note 55, at 15.
173. *Id.* at 16.
174. *Id.* at 17–18.
175. *Prepaid Card Hearing*, *supra* note 137, at 2.
176. Ody, *supra* note 165.

For example, of the 22 participants in the study by Gordon, Romich, and Waithaka, all but one previously had a bank account; but by the time they were interviewed as part of the study, 16 of 22 did not have a conventional bank account.[177] Their precise reasons for migrating out of the traditional banking system varied, but all focused on 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 fees, and others claimed they were the victims of identity theft or unauthorized account access.[178] In addition, most felt banks mistreated or ignored them in their efforts to resolve issues. They felt alienated from and distrustful of the mainstream banking system.[179]

A March 2012 study by the Board of Governors of the Federal Reserve found a general dislike of dealing with banks was the most commonly cited reason for being unbanked.[180] The Survey of Consumer Finances also consistently found that the most common reason consumers gave for being unbanked was a dislike of dealing with banks (25% of respondents). This response rose from 22.6% of respondents in the 2004 survey to 27.8% in the 2010 survey.[181]

Other studies also found unbanked customers shared a general distrust of banks. 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.[182] 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).[183] In some cases consumers could not cope with the complexity and

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177. Gordon, Romich, & Waithaka, *supra* note 38, at 12–13.

178. *Id.*

179. *Id.* at 12–14.

180. *See* BD. OF GOVERNORS, *supra* note 2, at 19.

181. BD. OF GOVERNORS OF THE FED. RESERVE, 98 FED. RESERVE BULL. NO. 2, CHANGES IN U.S. FAMILY FINANCES FROM 2007 TO 2010: EVIDENCE FROM THE SURVEY OF CONSUMER FINANCES 32 (2012).

182. FED. RESERVE BANK OF KANSAS CITY, A STUDY OF THE UNBANKED & UNDERBANKED CONSUMER IN THE TENTH FEDERAL RESERVE DISTRICT 2, 6 (2010), *available at* http://www.kansascityfed.org/publicat/research/community/Unbanked.Report.pdf.

183. *Id.* Note that although they considered these fees "hidden," that is a subjective assessment. At least some of the fees may have been unknown at the time, but others simply reflect a lack of experience or knowledge about bank accounts. Nevertheless, they 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 he needed to keep money in his account to use checks; he thought he could use checks as long as he had them in his checkbook. *Id*. at 7. For purposes of the current discussion, however, it is the subjective experience of the unbanked and underbanked consumers that matters in understanding their decision-making process when determining whether to adopt a bank account.

organizational demands of managing a bank account.[184] They also said that when conflicts arose with the banks over what they believed were erroneous charges, they "[did] not feel 'listened to' or 'believed' because of factors such as their lower income, manner of dress or language."[185] 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. They found access to those service providers more convenient than access to banks.[186] Hispanic consumers said they felt especially unwelcome by banks because of language barriers, and in some cases Hispanic immigrants could not open a bank account or cash a check because they lacked adequate identification.[187]

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.[188] For example, because underbanked consumers live closer to the financial edge, they often feel a need to access funds immediately rather than waiting through the two- or three-day hold period until a check clears at a bank.[189] Thus, they put a premium on physical control and immediate access to their money.[190] The benefits of a bank account may be lower as well. For example, several participants reported they could not use a check to pay their rent (their largest bill) but were required to use cash or money order.[191]

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 if they could open a bank account. In light of the escalating cost of bank accounts on the one hand and the declining costs of prepaid cards on the other, this decision may prove rational. Consumers who prefer prepaid cards express several reasons for using prepaid cards: prepaid cards impose self-control and typically do not permit overdrafting or paying more than they have; prepaid cards are less expensive than a checking account; prepaid cards give consumers privacy requiring less personal information than a checking account; it is much easier to purchase and load a prepaid card

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184. In one case, for example, a young woman reported that her parents helped her open a checking account but she was unable to manage it and ended up closing the account. *Id*. at 7.

185. *Id.* at 6.

186. *Id.* at 9. For example, many unbanked consumers work hours that make it inconvenient to bank during traditional banking hours. The paucity of bank branches 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. *See id.* at 12.

187. *Id.* at 6.

188. *Id.* at 7.

189. *Id.* at 6, 9.

190. *Id.* at 8.

191. *Id.*

than to open a checking account and make deposits; and they can obtain a prepaid card without a credit check.[192] In addition, some prepaid cards offer the ability to save money[193] and offer rewards.[194] Such features reduce the advantages associated with a traditional bank account, debit card, or credit card (especially since rewards on debit cards declined after the imposition of the Durbin Amendment).

3. Self-Control and Budgeting

Prepaid card users, especially those who experienced difficulty with financial management in the past, also state that prepaid cards help them control their finances and 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.[195] Although those who use overdraft protection generally are aware of the cost, there are some consumers who overdraft their accounts inadvertently and incur unexpected fees.[196] Prepaid cards, by contrast, generally do not offer overdraft protection or do so only in a limited manner. Prepaid card companies will usually decline consumers' transactions if they do not have sufficient funds to cover the purchase. In some instances, however, a delay between the initial authorization of a transaction and its clearing might lead to an overdraft if other transactions occur in the meantime.[197] In addition, prepaid cards offer additional services that assist consumers in managing their finances, such as providing instant

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192. I 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 the more relevant comparison is between debit cards and prepaid cards.

193. *See* Gordon, Romich & Waithaka, *supra* note 38 and accompanying text.

194. The 1-2-3 REWARDS Card, for example, offers rewards that consumers can redeem for gasoline and groceries. *See About the Card*, 1-2-3 REWARDS: PREPAID, http://www.kpfprepaid.com/about-the-card/index.asp (last visited July 22, 2013).

195. CTR. FOR FIN. SERVS. INNOVATION, *supra* note 161, at 2 (18.3% of underbanked consumers preferred prepaid cards to checking accounts); *see also* BRETTON WOODS, INC., *supra* note 163, at 4 (finding that 73% of respondents reported that the aspect they liked most about prepaid cards was that prepaid cards prevented them from overspending or overdrafting (citing LINKAGE RESEARCH AND CONSULTING, INC., *supra* note 41, at 2)); NAT'L COUNCIL OF LA RAZA, PERSPECTIVES ON PREPAID CARDS FROM LOW-INCOME HISPANIC TAX FILERS 3 (2011), *available at* http://www.nclr.org/images/uploads/publications/perspectives_on_prepaid_cards_ (3).pdf (noting that over 60% of Hispanics and over 50% of non-Hispanics reported that one of the things that prepaid card users liked most was that they could spend only the amount of money they had); AITE GRP., *supra* note 169 (finding that 48% of debanked consumers stated they "strongly agree" with the statement that prepaid cards are better than a checking account because of the inability to overdraft).

196. *See* Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 69 WASH. & LEE L. REV. 1141, 1174–75 (2012).

197. Most prepaid cards do not offer overdraft protection. *See* PEW CHARITABLE TRUSTS, *supra* note 55, at 3.

balance updates by text message.[198]

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.[199] 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.[200]

Prepaid cards may also offer a vehicle for credit building if consumers use them to pay recurring monthly bills and also elect to report the payments to a credit reporting agency.[201] In fact, celebrity financial advisor Suze Orman developed a new prepaid card that touts a feature for creating a credit history and improving credit scores.[202] Although this feature appears uncommon for prepaid cards today, consumers indicate they want more cards to add this feature.[203]

Debit and credit cards also require a credit check before approval, and some prepaid card users are not approved for debit or credit card products due to bad credit or negative ChexSystems reports of bounced checks or closed accounts.[204] Thus for those who cannot obtain a debit

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198. PEW HEALTH GRP., *supra* note 39, at 3. NetSpend, for example, allows consumers to personalize the notifications they receive. *See Go Mobile with Anytime Alerts*, NETSPEND, https://www.netspend.com/why_netspend/powerful_tools/anytime_alerts.shtml (last visited July 22, 2013).

199. *See* Gordon, Romich, & Waithaka, *supra* note 38, at 12; BRETTON WOODS, INC., *supra* note 163, at 4; JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 11 fig. 3.

200. A survey by the National Urban League found 26% of prepaid card customers reported that one of the things they liked best about prepaid cards was that the prepaid cards carried the logo of one of the major networks (Visa, MasterCard, American Express, and Discover). *See* BRETTON WOODS, INC., *supra* note 163, at 4. Javelin's survey found that nearly one-third of prepaid card users said that the ability to carry a major brand that would allow ubiquitous acceptance of prepaid cards would lead them to increase their use of prepaid cards. JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 7 fig. 3.

201. *See* CTR. FOR FIN. SERVS. INNOVATION, THE NONPROFIT'S GUIDE TO PREPAID CARDS 14 (2010), *available at* http://www.cfsinnovation.com/system/files/CFSI%20Nonprofit%20Guide %20to%20 Prepaid. pdf.

202. The accuracy of her claim, however, is challenged. *See, e.g.*, Kathy Kristof, *Suze Orman Card: Rip-Off or Righteous?*, CBS NEWS (Jan. 16, 2012, 8:38 AM), http://www.cbsnews.com/8301-505144_162-57359114/suze-orman-card-rip-off-or-righteous.

203. *See* PEW HEALTH GRP., *supra* note 39, at 3.

204. ChexSystems is a specialized "private database of consumers who have had deposit accounts closed while holding a negative balance." *See* PEW CHARITABLE TRUSTS, *supra* note 55, at 35 n.31 (citing *Big Brother Is Watching*, CONSUMER REPORTS (2009), *available at* http://www.consumerreports.org/cro/money/consumer-protection/big-brother-is-watching/overview/

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.[205] Consumers in lower income areas might not enjoy access to a traditional bank because bank branches are scarce in many of these neighborhoods.[206] As a result, unbanked consumers are more reliant on cash payments than banked consumers. According to the FDIC's 2011 survey of unbanked households, 23% of unbanked households used nonbank providers for products and services such as money orders, check cashing, or remittances.[207] The survey also found a dramatic growth in the use of prepaid cards by unbanked households in recent years. Such use rose from 12.2% in 2009 to 17.8% in 2011.[208]

Other financial options available to unbanked consumers are mostly limited to check cashing and money orders. Although systematic empirical research is lacking, it appears as though 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.[209] According to a 2006 report by Consumer Federation of America for example, check cashers on average charged 4.11% to cash a payroll check and 2.44% to cash a government benefits check.[210] Participants in the study by Gordon, Romich, and Waithaka reported paying as much as $13 per

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index. htm).

205. For example, 60% of prepaid card users in the Aite Group study expressed a preference for using checking accounts rather than prepaid cards, which suggests that prepaid card users are unbanked involuntarily rather than by choice. *See* AUFSEESER, *supra* note 43, at 6.

206. *See* DEYANIRA DEL RIO, NEIGHBORHOOD ECON. DEV. ADVOCACY PROJECT, PREPAID CARDS & FINANCIAL SERVICES IN LOW INCOME COMMUNITIES (2011), *available at* www.fdic.gov/about/comein/DelRioDec11.pdf.

207. FDIC, 2011 SURVEY, *supra* note 3, at 6.

208. *Id.*

209. *See* SUZANNE MARTINDALE & MICHAEL MCCAULEY, ADDING IT ALL UP: HOW PREPAID CARD FEES COMPARE TO CHECKING ACCOUNT FEES (Apr. 2011), *available at* http://www.defendyourdollars.org/pdf/Adding-It-All-Up.pdf.

210. JEAN ANN FOX & PATRICK WOODALL, CONSUMER FED'N OF AM., CASHED OUT: CONSUMERS PAY STEEP PREMIUM TO "BANK" AT CHECK CASHING OUTLETS 1–2 (2006), *available at* http://www.consumerfed.org/pdfs/CFA_2006_Check_Cashing_Study111506.pdf. The Consumer Federation of America study is the most recent systematic study of check cashing fees that I located. Nevertheless, those figures appear to be more or less valid today. According to the website of United Check Cashing the fees range from 1.5% to 5% depending on the state. *See FAQ*, UNITED CHECK CASHING, http://www.unitedcheckcashing.com/FAQ.asp (last visited July 22, 2013). Walmart charges less for both check-cashing services ($3 to $6 per check cashed) and for prepaid cards (issued for free). *Walmart MoneyCenter: Check Cashing*, WALMART, http://www.walmart.com/cp/Check-Cashing/632047 (last visited July 22, 2013).

check, or $40 to $60 per month, to cash checks.[211] Another study estimated that consumers who use check cashers pay $140 to $720 per year in fees.[212] 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% per month by avoiding check cashing, money orders, and other fees.[213] Twenty-seven percent of respondents to the National Urban League survey stated that one of the things they liked most about prepaid cards was that using a prepaid card was cheaper than using a check casher.[214] Moreover, because none of these studies account for the time, inconvenience, and risk of acquiring cash, these estimates surely underestimate the full costs of relying on cash.

Cash and money orders offer limited functionality and flexibility for online shopping and electronic transactions.[215] Additionally, consumers who use check cashers and money orders incur 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 keeps them from having to run multiple places to cash a check, buy money orders, and then deliver payments."[216] Prepaid card users find this convenience 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. Consumers can also load prepaid cards conveniently; according to one study, almost half of all prepaid cardholders used the most popular method to reload—online.[217]

Because carrying cash can be dangerous and can raise the risks of crime and loss, consumers tend to use electronic payments more

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211. Gordon, Romich & Waithaka, *supra* note 38, at 10, 14.

212. BRETTON WOODS, INC., *supra* note 20, at 13 (citing study by Chexar Networks, Inc.).

213. 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 INC, *supra* note 163).

214. *See* BRETTON WOODS, INC., *supra* note 163, at 4.

215. Although it is technically possible to shop online using a money order, many major sites such as Amazon.com do not accept checks or money orders and where money orders are accepted, the process is highly cumbersome and time consuming. *See Help: Payment Methods*, AMAZON.COM, http://www.amazon.com/gp/help/ customer/display.html/ref=hp_513058_lppaymethmore?nodeId=201132710 (last visited July 22, 2013).

216. Gordon, Romich & Waithaka, *supra* note 38, at 12; *see also* FED. RESERVE BANK OF KAN. CITY, *supra* note 182, at 9 (describing routines used by unbanked consumers to pay bills and organize their finances).

217. JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 29.

frequently in high-crime areas.[218] The National Urban League survey found that the second-most common reason for using prepaid cards, stated by 41% of respondents, is that prepaid cards are safer and easier to use than carrying cash.[219] Over 40% 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.[220] 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.[221]

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% of unbanked consumers who own prepaid cards use them regularly for online transactions, compared to 46% of all prepaid card customers.[222] 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% of respondents said that their cards were very or extremely useful, 74% said they were very likely or certain to recommend the card to others, 60% used their cards weekly, and 12% used them daily.[223]

IV. MARKET FAILURE AND REGULATORY RESPONSES

For many consumers, prepaid cards are less expensive and more functional than other payment alternatives. Their decision to use prepaid cards is rational and consistent with standard economic analysis. Nevertheless, some express concern that prepaid cards are unduly expensive for consumers, especially low-income, less educated, and less financially experienced consumers. They fear that these consumers may pay excessively for prepaid cards compared to alternatives. Such

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218. *See* Todd J. Zywicki, *The Economics of Payment Card Interchange Fees and the Limits of Regulation*, 2012 INT'L CENTER FOR L. & ECON. 17 n.57, *available at* http://www.laweconcenter.org/images/articles/zywicki_interchange.pdf (ICLE Financial Regulatory Program White Paper Series).

219. *See* BRETTON WOODS, INC., *supra* note 163, at 4. This does not imply that the other 73% thought check cashers were less expensive, just that prepaid card customers chose to use prepaid cards for reasons other than cost (such as convenience). *See id.*

220. NAT'L COUNCIL OF LA RAZA, *supra* note 195, at 3.

221. *See* BRETTON WOODS, INC., s*upra* note 163, at 4; NAT'L COUNCIL OF LA RAZA, *supra* note 195, at 3.

222. JAVELIN STRATEGY & RESEARCH, *supra* note 5, at 6.

223. CTR. FOR FIN. SERVS. INNOVATION, RESULTS OF THE NBPCA/CFSI SURVEY: SATISFACTION WITH AND USAGE OF PREPAID CARDS 1, 3 (2009), *available at* http://cfsinnovation.com/system/files/imported/managed_documents/nbpca_cfsi_final_3_.pdf.

criticisms produced calls for regulation of the terms and marketing of prepaid cards. Two rationales support regulatory intervention. First, a market failure may result from inadequate competition that produces higher prices and a monopoly power in the market. Second, some argue 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, some argue that prepaid cards harm consumers with higher prices and lower quality.[224]

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 legislators could fashion government regulation in such a manner to improve market outcomes. On the other hand, although there is little basis for remedial intervention in the name of competition or consumer protection, legislators might consider more modest market-reinforcing interventions that could proactively promote future competition and consumer protection rather than displace it with regulation.

A. *Competitive Failure?*

The first potential rationale for regulation is the existence of a competitive failure that intervention could remedy. But the prepaid card market appears exceedingly competitive and barriers to entry are low. New cards enter the market frequently, including cards provided by traditional financial service providers such as American Express and major banks, celebrity-branded cards, and cards aimed at particular demographic groups.[225] A company need not be a bank in order to enter the prepaid card market because prepaid cards are marketed to consumers through program officers. The program officers serve as the "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. For example, the two largest prepaid card providers—NetSpend and Green Dot—were not banks when they attained their leadership positions in the market.[226] 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

224. *See supra* notes 54–75 and accompanying text.

225. *See* Andrew R. Johnson, *Flood of Competition Weighs on Prepaid-Card Companies*, FOX BUSINESS, July 27, 2010, http://markets.m.foxbusiness.com/quickPage.html?page=32642&content=77126749&pageNum=-1; Susan Johnston, *The Pitfalls of Celebrity-Branded Cards*, MINT.COM (Jan. 3, 2011) http://www.mint.com/blog/trends/celebrity-prepaid-cards-01032011.

226. Green Dot subsequently did acquire a bank but it was not necessary to conduct its business. *Green Dot Buying Small Utah Bank*, BLOOMBERG BUSINESSWEEK, Nov. 23, 2011, http://www.businessweek.com/ap/financialnews/D9R6MI0G0.htm.

structures and the number of fees is steadily declining over time.[227] Especially for lower income consumers, the total price of holding and using prepaid cards fell in recent years even as the cost of traditional bank accounts trended up.[228] The quality of prepaid cards also rose as prices fell in the wake of heightened competition.[229] Prepaid cards now include new features such as linked savings accounts; web, text, and email alerts; electronic statements; and mobile banking.[230]

Striking features of the prepaid card industry are the ease by which consumers can switch cards and the fierce competitive efforts companies exert to attract new customers. Switching debit cards usually entails switching bank accounts, which can prove a difficult and tedious process, especially for lower income consumers who may suffer from blemished financial records. Switching credit cards can also prove difficult for those with impaired credit because they may not receive approval for a new credit card. Prepaid cards, by contrast, generally require no credit check, and feature minimal transaction costs when switching from one prepaid card to another. Indeed, a consumer can even transfer funds easily from one prepaid card to a new one electronically.

Data from the Federal Reserve also indicate the ease with which consumers can switch prepaid cards compared to alternatives.[231] For example, in 2009 only 9% of consumers discarded one or more of their debit cards and 16.5% discarded one or more credit card.[232] By contrast, 29% of consumers discarded at least one prepaid card.[233] There is little reason to believe that there is a competitive market failure in the prepaid card market given 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. As noted, in contrast to the media's and regulators' criticism of prepaid cards, prepaid card customers generally express high levels of satisfaction with their cards

227. *See* discussion *supra* notes 56–70 and accompanying text.

228. BRETTON WOODS, INC., *supra* note 163, at 10; *see* PHILIP KEITEL, FED. RESERVE BANK OF PHILA., FEDERAL REGULATION OF THE PREPAID CARD INDUSTRY: COSTS, BENEFITS, AND CHANGING INDUSTRY DYNAMICS 18–19 (2010), *available at* http://www.philadelphia fed.org/consumer-credit-and-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).

229. *See* KEITEL, *supra* note 228, at 18.

230. *See Go Mobile with Anytime Alerts*, *supra* note 198; *Out of 82 Prepaid Debit Cards, Find the One for You*, *supra* note 107.

231. *See* Foster et al., *supra* note 24, at 45–46.

232. *Id.*

233. *Id.*

that are consistent with the hypothesis that the market is competitive.[234] Moreover, although issuer revenues have grown as the market has grown, there is 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) sagged as a result of heightened entry and competition.[235]

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

A market failure might support government intervention if consumers either 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, regulators could justify intervention if they reduced fees or required the disclosure of certain terms or fees.[236]

Based on 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. 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 the fees for using their cards were fair, and an even greater number said they understood the fees well.[237] Interviews by Gordon, Romich, and Waithaka revealed that consumers found the fee structures of prepaid cards transparent and easy to understand, that they had knowledge of the fees for their transactions, and that there were not unexpected fees.[238] They also thought the fees charged were fair.[239] 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.

234. *See* discussion *supra* notes 41–43 and accompanying text.

235. *See* Johnson, *supra* note 225. In fact, to the extent that any barrier to entry exists, the barrier is one of the perverse effects of the Durbin Amendment that chilled entry into the market by larger banks. *See* discussion *infra* Section IV.C.

236. This assumes, of course, that any such intervention is well-tailored to address and correct the identified problem.

237. CTR. FOR FIN. SERVS. INNOVATION, *supra* note 195, at 5.

238. Gordon, Romich & Waithaka, *supra* note 38, at 13.

239. *Id.* at 14.

> This is the cost of the card; this is the cost for the services. It's up to you at that point.[240]

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.[241] Indeed, despite the various fees on prepaid cards, the number of potential fees on checking accounts and credit cards is even larger.[242] 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.[243]

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 à la carte fees) and another plan that charges no monthly fee but charges a per-transaction fee instead.[244] Seventy-four percent of NetSpend's customers choose the per-transaction plan rather than the monthly-fee plan.[245] According to data provided to the author by NetSpend, its customers overwhelmingly choose the 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.[246] Five percent pay monthly but do not use the card frequently enough to justify the flat fee, and 21% pay on a per-transaction basis but use the card enough to warrant selecting the monthly fee plan.[247] Users select a card plan at the time of activation, but about 11% switch from one plan to another during their tenure. In addition, NetSpend says that it has a proactive outreach program to inform customers of less expensive options.[248] 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

240. PEW HEALTH GRP., *supra* note 39, at 1.

241. *See supra* notes 238–40 and accompanying text.

242. PEW HEALTH GRP., *supra* note 39, at 1.

243. *See* Gordon, Romich & Waithaka, *supra* note 38, at 13.

244. E-mail from Lisa Henken, Netspend, to Todd J. Zywicki, Professor of Law, George Mason Univ. Sch. of Law (Apr. 17, 2012, 11:33 PM EST) (on file with author).

245. E-mail from Lisa Henken, Netspend, to Todd J. Zywicki, Professor of Law, George Mason Univ. Sch. of Law (Apr. 30, 2012, 4:18 PM EST) (on file with author).

246. E-mail from Lisa Henken, *supra* note 244.

247. *Id.* 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 where consumers who elect the monthly fee card then proceed to use it more.

248. *Id.* 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.

mistakes. As a result, if regulation foreclosed 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 advocates of intervention abstractly criticize prepaid cards and allege 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, they provide no tangible evidence that this is actually the case. Thus, even while deep regulatory intervention is unwarranted, regulators should consider milder, market-reinforcing regulation that promotes more robust competition and consumer choice in the market.

In fact, the biggest single obstacle to increased competition and consumer welfare today is not any failure of competition, but rather the Durbin Amendment. And the single most effective step that could benefit consumers and promote market competition is to repeal the Durbin Amendment, allow market forces to set interchange fees, and allow debit 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 uniquely positioned to develop prepaid cards that function either as alternatives to bank accounts or as bridges from prepaid cards to bank accounts and other traditional banking services. The Durbin Amendment chills this competitive pressure by forcing large banks to choose between either offering cards with reduced functionality and features or exposing their cards to the Durbin Amendment's interchange fee price controls (which, if applicable, would force large issuers to raise other fees or reduce services).[249] 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.[250] Most prepaid cards are issued by a program manager (such as NetSpend) that collects the customer's money and then, for administrative purposes, deposits the money in a pooled account. The account is held in the name of the

249. *See supra* notes 107–09 and accompanying text.

250. For a brief explanation, see *Prepaid Cards & Deposit Insurance*, NETWORK BRANDED PREPAID CARD ASSOCIATION, http://www.nbpca.com/en/Government-Affairs/Policy-Positions/Deposit-Insurance. aspx (last visited Mar. 29, 2013).

program manager. Once the funds are pooled, the total amount in the program manager's account easily exceeds the $250,000 limit for FDIC insurance.[251] In theory, this arrangement could provide insecurity for customers' funds. In practice, however, the FDIC issues guidance to banks on how to preserve FDIC pass-through insurance on individual cardholders' accounts.[252] 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[253]—provides FDIC pass-through insurance for its customers.[254] According to the Pew Study, more than 90% of the prepaid card programs in the study offered FDIC deposit insurance pass-through.[255] Most consumers believed that their deposits were insured.[256] In practice, the lack of FDIC pass-through appears more of a theoretical problem than a real problem. This suggests that both the benefits and costs of mandating FDIC pass-through are likely 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. The CFPB issued an Advance Notice of Proposed Rulemaking on the question of whether to extend Regulation E to prepaid cards.[257] Nevertheless, all of the prepaid cards Pew studied offered some type of contractual protection

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251. *Id.*

252. *See* Insurability of Funds Underlying Stored Value Cards and Other Nontraditional Access Mechanisms, 73 Fed. Reg. 67155, 67156 (Nov. 13, 2008) (describing the process for providing deposit insurance for prepaid cards).

253. American Express cards are not FDIC insured because American Express is not a bank and pools its customers' accounts rather than segregating them. *See More about the Amex Prepaid Card*, BANKTALK (June 24, 2011), http://banktalk.org/2011/06/24/more-about-the-amex-prepaid-card. The funds on American Express cards are protected by state transmitter laws. *See* CONSUMER ACTION, PREPAID CREDIT CARD SURVEY: 2012, at 15 (2012), *available at* http://www.consumer-action.org/ downloads/press/2012_Prepaid_Card_Survey.pdf; *Money Services Business Disclosures*, AMERICAN EXPRESS, https://www.americanexpress.com/us/content/prepaid/state-licensing.html?vgnextchannel=95ddb81e8482a110VgnVCM100000defaad94RCRD&appinstancename=default (last visited July 22, 2013).

254. *See* CONSUMER ACTION, *supra* note 253, at 3–4. The universality of providing FDIC pass-through insurance is driven in part by a requirement that any bank that provides clearance services for federal government benefit cards must comply with FDIC regulations in order to offer FDIC pass-through insurance. *See* Federal Government Participation in the Automated Clearing House, 31 C.F.R. § 210 (2010), *available at* 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.

255. PEW CHARITABLE TRUSTS, *supra* note 55, 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 26 featured disclosures. *Id.* at 10.

256. *Id.* at 4, 10.

257. Electronic Fund Transfers (Regulation E), 77 Fed. Reg. 30,923 (proposed May 24, 2012) (to be codified at 12 C.F.R. pt. 1005).

for unauthorized transfers.[258] 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.[259] In practice, however, issuing networks offer fraud protection on prepaid cards similar to that offered on debit cards. As one commentator 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."[260] Thus, again, both the benefits and costs of extending Regulation E protection to prepaid cards are relatively small. On the other hand, certain features of Regulation E, such as the period of time during which a bank can hold a suspicious charge and the requirement that banks issue periodic statements to customers, may not suit prepaid cards due to the heightened potential for fraud. Also, the "transient" nature of prepaid card customers makes recovery difficult in the event that an issuer later wins a dispute over a charge.[261]

Some also propose that the industry adopt a standardized format for disclosure of prepaid card fees modeled after the "Schumer box" for credit cards.[262] Pew's analysis found that card fee disclosure was often incomplete and it was often difficult to ascertain whether a card had a certain fee.[263] Although most prepaid card customers state that they understand their card fees, the National Urban League found that 24% of survey respondents did not understand all of the card fees when they acquired their cards and that 23% claimed they were charged an unexpected fee. This pattern suggests room for improving disclosures to assist consumer understanding and comparison shopping.[264] These remaining problems may prove self-correcting as a result of the trend

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258. PEW CHARITABLE TRUSTS, *supra* note 55, at 20.

259. *Id.*

260. Douglas A. King, *Dispelling Prepaid Card Myths: Not All Cards Are Created Equal*, FED. RESERVE BANK ATLANTA (July 5, 2011), http://portalsandrails.frbatlanta.org/2011/07/dispelling-prepaid-card-myths-not-all-cards-created-equal.html.

261. For discussion, *see* Letter from Mary Mitchell Dunn, Senior Vice President and Deputy General Counsel, Credit Union Nat'l Ass'n, to Monica Jackson, Office of the Executive Secretary, Consumer Fin. Protection Bureau (July 23, 2012), *available at* http://www.cuna.org/download/cl_072312.pdf (regarding the notice of proposed rulemaking for electronic fund transfers).

262. *See* DAVID NEWVILLE, CTR. FOR FIN. SERVS. INNOVATION, THINKING INSIDE THE BOX: IMPROVING CONSUMER OUTCOMES THROUGH BETTER FEE DISCLOSURE FOR PREPAID CARDS 4, 7 (2012), *available at* http://cfsinnovation.com/system/files/CFSI_Prepaid%20Cards%20White paper%20FInal_0.pdf.

263. 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 CHARITABLE TRUSTS, *supra* note 55, at 3.

264. *See* LINKAGE RESEARCH CONSULTING, INC., *supra* note 41, at 2.

toward eliminating fees and as a result of consumers gaining experience with the product.

A standardized disclosure format could prove useful to consumers and to the competitive process because it would enable consumers to easily find the card that is most appropriate for their purposes. Regulators must ensure that the information is provided in a user-friendly way and that the fees that require disclosure in the standardized format are relevant to consumers. Regulators should also subject disclosures to periodic review and updates in light of product innovations and changing consumer preferences. In addition, regulators should copy test any mandated disclosures and ensure they improve consumer comprehension and decision making.

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 increased demand for prepaid cards as regulation raised the costs of and reduced access to debit and credit cards especially among lower income and younger consumers. At the same time, the need for access to electronic payments increased.

Prepaid cards crept toward the mainstream of the consumer payments market, and now spur greater competition and produce 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, scholars and regulators cannot identify a cognizable market failure or failure of consumer protection that justifies remedial governmental intervention.

Given the regulatory havoc wreaked on the debit and credit card systems during the past several years, prepaid cards are increasingly becoming a final resort for many consumers who are 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 the dynamic and evolving prepaid card market that provides value and choice to millions of Americans.