Prepaid Credit?

Payroll Advances as a Way to Introduce Credit

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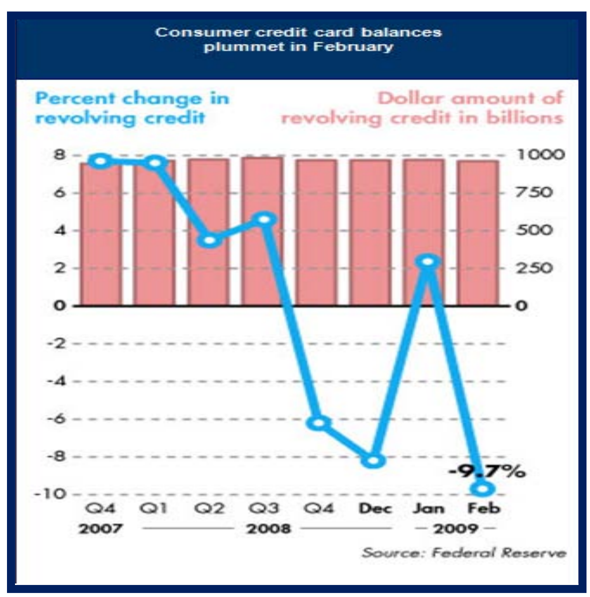
Introduction

One of the best kept payment secrets in the payment industry has been the actual time it takes a cardholder to pay off a credit card balance and the amount of interest a cardholder has to pay when they make only the minimum monthly payment. The maximum profit potential for financial institutions has been the driving force behind issuing a credit card. Encouraging the cardholder to revolve as much of their balance as possible was the way to achieve that profit. The credit card issuing business is not for the weak at heart because the greatest profits mean getting the cardholder to a point where they are paying only the minimum required and therefore maximum interest while not being delinquent. For example, consider a balance of $1,000 at 18 percent APR or 1.5 percent per month where if the cardholder pays only the minimum payment, the balance would be repaid after 13 years and result in about $1,115 in interest.

As consumers have become educated about the cost of credit, fewer cardholders are revolving their balances. The global economic problems and the credit crunch in 2009 coupled with new legislation surrounding transparency in lending have been the final straws in the dwindling use of credit cards. The old profit models have been under fire and financial institutions have had to up the ante by introducing clever interest calculation methods such as automatically increasing interest rates if there is even one payment missed or charging higher fees for being over limits. Fees have replaced interest rates as the profit-making mainstay of the credit card business and have become somewhat of an addiction for financial institutions adding to the already negative perception consumers have of the mercenary nature of the credit industry.

The global credit crisis has created a silent war between cardholders and issuers. Consumers have realized the errors of being over extended and the true cost of carrying a balance. They have sought to pay down their balances, put away or shred their credit cards and in some cases have chosen bankruptcy. According to the United States Federal Reserve, February 2009 saw the biggest drop in credit card usage in 31 years.



The year 2009 also saw new U.S. legislation regarding credit card reform. The Credit Card Accountability Responsibility and Disclosure Act, otherwise known as the Credit CARD Act of 2009, is an effort to protect cardholders by restricting existing card fee practices. Per language in the legislation, it seeks "...to establish fair and transparent practices relating to the extension of credit under an open end consumer credit plan, and for other purposes." The legislation prompted the American Bankers Association to warn that the opposite – meaning more fees as opposed to less– might actually be the result as banks look to find ways to keep profitability levels the same or higher.

At roughly the same time, the prepaid card industry continued to grow. Early adopters of prepaid programs began to quickly realize that the initial fee-intensive product offerings had the potential of giving prepaid the same bad press that credit had received. Credit and debit were fighting a battle involving fees and practices that were less than transparent. Prepaid issuers and legislation quickly moved to protect consumers by making sure that programs were more sensitive to cardholders. With reasonable fee structures, transparency and less of a chance of penalties for exceeding limits or account balances, prepaid could now be the payment product of choice. According to the Mercator Advisory Group, an independent research firm for the consumer payments industry, general purpose prepaid cards – i.e. cards that are branded by international card associations and not restricted to specific merchants – are expected to surpass the closed loop volume for the first time by 2012.

The prepaid phenomenon has started servicing a new sector – the under-banked; consumers who are able to have banking services but have found themselves disenchanted by bank fees. This sector looks to prepaid products that help them budget their spending. Prepaid program managers knew that this new customer segment was looking for a different product, wanted freedom from the fees and interest traps and that 'pay before' offerings would be the tool that these consumers would be attracted to.

Estimated Prepaid Card Loads
(in $ billions by type of card)

	Closed-Loop	Open-Loop	Total	Change, Closed-Loop	Change, Open-Loop	Change, Total
2006	$171.2	$27.9	$199.1	n.a.	n.a.	n.a.
2007	$179.6	$40.7	$220.3	4.9%	45.9%	10.6%
2008	$187.2	$60.4	$247.6	4.2%	48.4%	12.4%
2009	$196.4	$94.0	$290.4	4.9%	55.6%	17.3%
2010	$207.3	$143.3	$350.6	5.5%	52.4%	20.7%
2011	$219.6	$207.9	$427.5	5.9%	45.1%	21.9%
2012	$233.8	$292.0	$525.8	6.5%	40.5%	23.0%

Source: Mercator Advisory Group

The prepaid traditional market which was the unbanked had not yet had the credit experience. There was definitely the opportunity to introduce credit with a conscience, and, therefore, a new role emerged for prepaid to inadvertently become the tool to introduce consumers not previously familiar with credit to credit products.

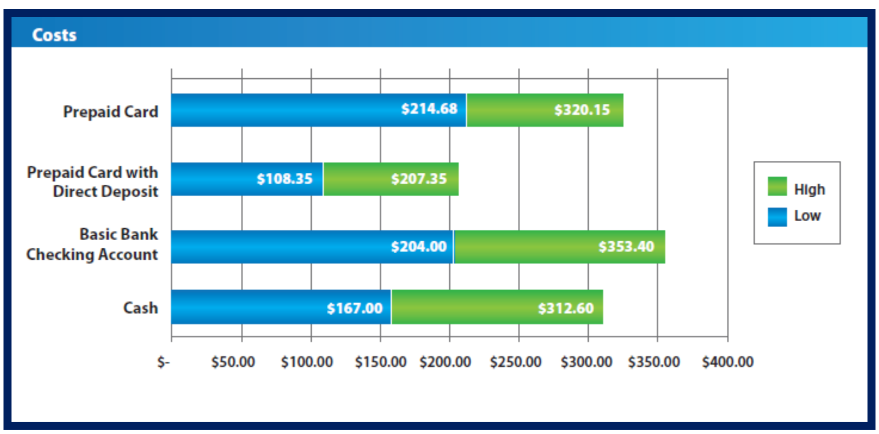
Certainly, the events of the last year – the collapse of the "house of cards" and the resulting onerous legislation – have jeopardized the reputation and the income of card issuers. After years of predictable growth, credit card issuers now need to reinvent themselves and consider new models that enable them to leverage their investments and infrastructures. They also need to preserve income associated with traditional credit models. This remainder of this document looks at the possible role of payroll prepaid cards and how advances on these cards may help to keep credit alive.

It May Cost Less to Use Prepaid

In a recent economic study by Michael Flores of Bretton Woods, Inc., a specialty management consulting firm serving financial institutions, it was discovered that consumers who opted to use a general purpose prepaid card actually paid between 25-70 percent less for the service compared to a low balance checking or debit account.

The comparison revealed:

- A typical consumer with a low balance checking account can expect to pay $200 to $350 annually. These costs include overdraft charges, ATM fees and minimum balance fees.
- Consumers without access to traditional banking and without a prepaid card must rely on a patchwork system of money orders, check cashing services and bill-payment fees. The fees associated cost the user from $167 to over $312 annually.
- A consumer who chooses a prepaid card instead of a bank account with direct deposit (commonly for payroll or a government benefit) may pay between $108 to $207, which equals a savings of $96 to $146 over a basic checking account.
- General purpose prepaid card users can expect to pay $215 to $320 annually.



Source: Payment Systems Evolution and Branded Prepaid Card Analysis by Bretton Woods, Inc.

Prepaid Salary Advances

Prepaid cards have been the phenomenon amongst all of the chaos experienced in the payment industry. General purpose prepaid cards challenge the conventional gift, credit and debit card markets with payroll or salary cards becoming an increasingly popular product. Financial institutions have the ability to provide a service to their corporate clients while at the same time reaching customers that may not have otherwise had a relationship with that institution.

Payroll card programs are typically introduced and marketed in association with an employer. Employers with seasonal or temporary workers also benefit from the use of prepaid salary cards. The main advantages to the employer are to streamline salary payments and benefits distribution as well as to replace the operational headache of issuing checks and, in some cases, handling pay packets. Benefits to the financial institution include the chance to offer traditional banking services to consumers who may not have qualified or who may not desire existing product offerings, and then gradually move these customers toward financial inclusion. Operational cost reduction and profitability are benefits that can be reaped by both financial institutions and employers. Processing fees are typically charged directly to the employer.

How the Salary Card Works

Registration

Employers maintain name, address, identification (ID) information, etc., on their employees; often that information is exchanged with the financial institution when creating an employee card. Banks in turn use this information to start building profiles on these cardholders. Over time, new products are introduced to these employees, sometimes beginning with a salary advance of one pay period's salary on the salary card.

Information exchange between the employer and the financial institution is usually via electronic file but in the case of small employers an application form can be used to get the client information into the card system.

Card Issuance and Distribution

Cards are created for each employee once the employee information file is loaded into the card management system. In some cases, these cards may be personalized with the cardholder's name on the card or they can be anonymous. In all instances, the link between the card, the employee and the employer is the employee ID. Distribution of the cards can be directly to the cardholder or via the employer.

Activation

Once received, the cardholder uses one of the financial institutions' channels – a customer service representative, telephone service, ATM or the Internet – to activate the card.

Salary Loads

To the financial institution, the employer submits a salary upload file containing the employee ID, the date and the salary amount that should be loaded to the card each pay period. Some solutions restrict the exchange of account data because of concerns from PCI-DSS, a set of comprehensive requirements for enhancing payment account data security.

Some programs restrict the loading of funds on cards to the employers only because there may be an arrangement between the financial institution and the employer regarding the liability for the card balances and fees associated with transactions. Additionally, financial institutions may not want to jeopardize their ability to offer other card products and therefore have employees evolve beyond the payroll product.

Access

More often than not, payroll cards are general purpose cards. This allows acceptance of the cards at a larger network of ATMs and merchants. Access can also be restricted to local use or inter-country transaction switching networks.

Payroll Advances

A model that is evolving is advances of the salary prior to the pay period to cardholders that have shown control and responsibility in the usage of their payroll cards. Their card history is reviewed and based on satisfactory behavior an advance of the salary is made. The simplest form of this practice involves a fee which is included in the advance amount. Credit lines and interest calculations are introduced as another card product rather than on the salary card.

The decision to offer payroll advances may be made in partnership with the employer or by the financial institution on its own – it depends on who is liable for the advance.

Advances on a payroll card are a definite introduction to credit for the unbanked and a means of financial inclusion. Over time, a separate card – a credit card – might be issued, as there would now be a customer history.

In cases where the payroll prepaid card is an anonymous card, the salary advance option may not typically be offered unless there is a guarantee by the employer.

Conclusion

There is still a chance for credit, and if financial institutions are to achieve the same levels of profitability, they must embrace new and innovative approaches to old product offerings and tap into the bounty of new payment instruments like general purpose prepaid cards. Mercenary card fees and exorbitant interest rate hikes are things of the past especially when regulation requires transparency, and when the average client is more aware and more cautious when dealing with payment products.

About Euronet

Euronet Worldwide is an industry leader in processing secure electronic financial transactions. The company offers payment and transaction processing solutions to financial institutions, retailers, service providers and individual consumers. These solutions include comprehensive ATM, POS and card outsourcing services; card issuing and merchant acquiring services; payment software solutions; consumer money transfer and bill payment services; and electronic distribution for prepaid mobile airtime and other prepaid products.

Euronet's Electronic Financial Transaction (EFT) division processes transactions for a network of over 9,700 ATMs and approximately 53,000 POS terminals across Europe, the Middle East and Asia-Pacific. We provide comprehensive electronic payment solutions consisting of ATM network participation, outsourced ATM and POS management solutions, cross-border transaction processing services, credit and debit card outsourcing and electronic recharge services for prepaid mobile airtime. We own and operate transaction processing centers in Hungary, Greece, Serbia, India and China, and serve an impressive client and partner portfolio of over 100 customers including banks, card organizations, mobile operators and retailers.

On both an outsourcing and in-house solution basis, Euronet provides a suite of payments software offerings for card issuing, transaction acquiring, mobile access, mobile commerce and transaction delivery systems utilizing an integrated payments hub strategy. With clients in over 70 countries, Euronet's software solutions service customers ranging in size from single community banks to multi-organization processing environments.

With Euronet, you benefit from 35 years of diverse payments experience and gain a focused partnership with an industry leading, financially sound, global organization. Make the smart choice by choosing Euronet – an organization uniquely positioned to meet your diverse needs - anytime, anyplace.

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