

Prepaid's Next Wave

Emerging products and markets bring new opportunities to ISOs

By Julie Ritzer Ross



KEY NOTES

- ▶▶ While the number of private-label gift card transactions processed in the U.S. rose from 810 million in 2001 to 2.43 billion in 2007, growth is leveling off.
- ▶▶ Digital media cards are among the most rapidly growing product segments in the prepaid market and will hit close to \$9 billion by 2011, nearly doubling in size from 2009.
- ▶▶ Of prepaid financial services products, payroll cards, in particular, are emerging in part because significant obstacles to implementation have disappeared.

With all of the development that has occurred in the prepaid card arena over the past few years, it wouldn't be unreasonable to consider further evolution unlikely. Yet the scope of the prepaid market continues to broaden, with new iterations of closed-loop, private-label cards good at a single retailer, as well as of universally accepted open-loop cards, surfacing at seemingly every turn.

"We are definitely looking at a moving target," says Ed Lawrence, managing director of Auriemma Consulting, a Westbury, New York-based financial industry consulting firm.

Combination Cards

On the closed-loop front, demand for products that meld prepaid and loyalty components is rapidly increasing. Merchants structure their programs so that a single card stores both a dollar value and accrued points or spending totals. Some players kick off such initiatives by loading gift cards with a small amount of money as an incentive to cultivate and retain new customers.

"Five years ago, fewer than 10 percent of our accounts were interested in a combined prepaid/gift product," says Thom Aldredge, president of World Gift Card in Plano, Texas "Today, that volume exceeds 20 percent." Aldredge believes the change stems partially from a heightened realization among merchants that leveraging the richer base of information from integrated stored value/loyalty applications is a critical competitive weapon.

Recently launched prepaid/loyalty card initiatives run the gamut of merchant sizes and types. One of World Gift Card's major customers, a big-box retailer with nearly 70 stores in the United States, jumped on the combined prepaid/loyalty card bandwagon this past March. On the foodservice front, Rockville, Maryland-based, 39-unit California Burrito recently distributed to customers more than 200,000 "Burrito Elito" electronic loyalty cards, which double as stored value cards.

Obstacles Ahead?

While the prepaid card market is clearly evolving, potential obstacles to growth lie ahead. Some roadblocks come in the form of new legislation. Notably, Title IV of the Credit Card Accountability, Responsibility and Disclosure (CARD) Act of 2009, signed into law by President Obama this past May, imposes limits on issuers of gift and prepaid cards. Slated to become effective within 15 months of the signing date, Title IV holds that dormancy and fees on closed-loop gift cards cannot be charged unless such fees have been fully disclosed, and then only after such cards have remained unused for one year.

The original version of Title IV included a similar proviso covering open-loop prepaid cards. However, it was modified at the urging of a variety of experts and entities, including the Electronic Funds Transfer Association, based on the fact that if the primary revenue sources for prepaid cards were eliminated through restrictions of service fees collected by issuers, the products would no longer be profitable and might no longer be offered at retail.

Title IV also holds that expiration dates on all gift cards cannot be less than five years from either the original date of purchase or from the date of the most recent reload to the card, and must be fully disclosed to the purchaser. Per the Act itself, the Federal Reserve must, by late February 2010, prescribe regulations to carry out Title IV, "including such additional requirements as appropriate relating to the amount of dormancy fees, inactivity charges or fees, or service fees that may be assessed and the amount of remaining value of a gift certificate, store gift card, or general-use prepaid card below which such charges or fees may be assessed."

Meanwhile, Congress is mulling over the so-called Fair Gift Card Act of 2009, sponsored by Sen. Charles Schumer (D-New York). Recently referred to the Senate Committee on Banking, Housing, and Urban Affairs, the Act is intended to prohibit unfair or deceptive acts or practices relating to "gift certificates, store gift cards, and other general-use cards." It would restrict issuers from imposing any fees until a card is at least two years old and has a remaining balance of less than \$5, prevent monthly fees from exceeding \$1, and render all cards valid for at least five years.

The Senate is also considering an amendment to the Bank Secrecy Act (BSA) to treat stored value-cards as monetary instruments. Under current BSA requirements, financial institutions must keep records of cash purchases of negotiable instruments; file reports of cash-based negotiable instrument purchases totaling \$3,000 or more (daily aggregate amount); and report suspicious activity that might signify money laundering, tax evasion, or other criminal activities.

Federal and state regulatory and enforcement agencies also are under pressure to come down harder on prepaid card compliance infractions.

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—Cherie Fuzzell, FirstView LLC

And in yet another vertical market, four-unit convenience store operator ShortStop of Boulder, Colorado, has rolled out a program in which participants use their cell phones and mobile commerce technology from Mocapay Inc., also of Boulder, to participate in a prepaid/loyalty card program. A mobile gift card function lets consumers execute transactions in ShortStop stores, using their cell phones to apply balances from prepaid gift/stored value accounts as well as to monitor monetary balances, load additional funds into their accounts, and check/redeem accrued incentives. A pilot test showed mid-single-digit adoption rates for the gift offering, high single-digit stored value/gift transaction volumes, and low-double-digit prepaid program load amounts, says co-owner Tony Dageenakis.

Dageenakis and his fellow merchants may have discovered what could be the saving grace of the closed-loop prepaid market, say some experts. “The recession has depleted the amount of disposable income in consumers’ pockets, which is inducing them to demand big bargains retailers have begun to deliver,” suggests Adil Moussa, a senior analyst with Aite Group LLC in Boston. “The shopper mindset has become, ‘Why should I buy someone a \$25 gift certificate, when I can buy that person a much nicer item at

75 percent off the original retail price?’ The loyalty piece gives merchants a shot at reversing that mindset.”

While the number of private-label gift card transactions processed in the U.S. rose from 810 million in 2001 to 2.43 billion in 2007, growth is leveling off and will only reach a level of 2.45 billion cards, representing sales of \$39 billion annually, by 2011 (up from \$38 billion in 2008), according to Aite’s *Private Label Prepaid Card Vendors: An Evaluation* report. Moreover, the study pegs the average number of private-label gift cards purchased in the U.S. each year at 4.1 per consumer in 2001 and 5.7 per consumer in 2005, when the market peaked. However, it cites a downward trend since 2006, with the average number of private-label gift card purchases expected to stand at 4.2 cards per consumer this year.

Emerging Markets

The closed-loop prepaid space is also seeing heightened interest in nontraditional retail cards and card programs. Digital media cards, which allow consumers to prepay for access to online video-style game sites, download ring tones, and the like, constitute a key example. Mercator Advisory Group recently deemed digital media cards to be among the most rapidly growing product segments in the prepaid mar-

ket. The firm anticipates this market will hit close to \$9 billion by 2011, nearly doubling in size from 2009, says Tim Sloane, director of Mercator’s debit and prepaid advisory service.

“In general, gaming is surpassing pre-recorded video,” says Brian Parlotto, senior vice president of products and international sales at prepaid card provider InComm in Atlanta. “This should lead us to a very nice spot with our retail partners and gaming partners in the next three to four years.”

InComm’s prepaid game card distribution base now includes more than 145,000 retail locations, with additional outlets planned. In 2008, InComm reported growth of nearly 200 percent in the sale of game cards from more than 60 online gaming companies.

Meanwhile, although network-branded general purpose prepaid cards continue to gather steam, more specialized cards have begun to make their mark. Open- and closed-loop prepaid products designed to deliver employee or consumer incentives top the list. “Instead of disbursing cash or writing checks, companies give a prepaid card that can be redeemed for a selection of rewards, merchandise, or financial,” explains Peter Quadagno, president of Quadagno & Associates, a card-based technology consulting firm headquartered in West Chester, Pennsylvania.

Earlier this year, Springbok Services of Englewood, Colorado, introduced Springbok EZ Spend, which allows businesses to e-mail prepaid rewards to customers and employees. Recipients are issued a prepaid account with a standard 16-digit account number, expiration date, and security value. Funds called EZ Dollars are loaded onto that account and may be spent online or via telephone.

Financial services cards intended for employee payment, bill payment, money transfer, and electronic benefits transfer are gaining momentum as well. "There are several factors at work here," says Lori Breitzke, president of E&S Consulting LLC, a prepaid card consulting firm headquartered in Atlanta. "The economy is driving more consumers to acquire different bank products. Companies are being creative to satisfy multiple consumer needs. And consumers want to be able to pay bills close to the due date and via the lowest cost method."

Employers' desire to save money and heightened recognition of the potential to serve the under banked market are among the catalysts for growth, adds Auriemma's Lawrence. "We are talking not just about under banked consumers in general, but about the 30 to 40 million consumers who are considered under banked and may be good credit risks but just don't want to do business with a bank."



Of prepaid financial services products, payroll cards, in particular, are emerging in part because significant obstacles to implementation have disappeared, adds Cherie Fuzzell, president and CEO of FirstView LLC, a prepaid processor and program manager in Atlanta. The original payroll card processing infrastructure did not allow cards to be "transported" from one employer to another when cardholders changed jobs, but that's no longer the case, she says.

Additionally, card delivery, which was

once problematic, is now easier thanks to the Internet. Uncertainty over whether the funds loaded onto the cards were insured in the same manner as funds in checking and savings accounts—another major roadblock at one time—has also been cleared. Payroll cards are now insured by the Federal Deposit Insurance Corporation (FDIC) and come with consumer data privacy protections, such as Regulation E of the Electronic Funds Transfer Act and the U.S. Patriot Act.

Fuzzell foresees companies with high employee turnover, staffing firms/professional employer organizations (PEOs), companies with part-time or seasonal workers, and youth programs as especially fertile outlets for payroll cards. Just as significantly, she claims ISOs will leverage one of two payroll card program manager strategies to capitalize on opportunities in this segment. In one scenario, ISOs will partner with banks to

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The second strategy is linked with a turn-down model. Here, banks that decline to open accounts for customers based on bad credit histories or low scores on eFunds Inc.'s ChexSystems check verification and credit reporting service will steer such clients to ISOs' payroll card products.

"The degree of integration varies broadly—from merely handing the customer a flyer describing the product to actually enrolling the customer in the product, providing them with an 'instant issue' card, and crediting the initial deposit," Fuzzell says. "A revenue share is also available to banks for customers generated through the turn-down model."

Although ISOs generally identify cor-

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porate opportunities directly, those that partner with banks to offer merchant services will be able to cross-sell payroll card solutions on behalf of their banks, she says. "There is a strong cross-sell opportunity for ISOs in this channel, just like with other prepaid cards."

New Audiences

Regardless of the type of prepaid card programs they promote to merchants, ISOs must bear in mind that the prepaid audience is not just growing; it extends beyond the commonly assumed demographics of low-income and younger consumers.

Consumer use of prepaid card products "has spread relatively evenly among

most income groups," with middle-income Americans demonstrating the highest adoption of prepaid products both online and offline, according to Bruce Cundiff, director of payments research and consulting for Javelin Strategy & Research in Pleasanton, California. "The multi-channel nature of the prepaid relationship with middle- to higher-income consumers demonstrates and validates the revenue stream capabilities prepaid provides to merchants as well as to the ISO community." **TT**

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