

Prepaid cards offer great banking potential

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Prepaid products or platforms can be used to cover everything from collecting microdeposits to paying monthly bills.

How often do you use that little piece of plastic in your wallet for a transaction? Whether for cash withdrawals, Internet purchases, direct debits or bill payments, cards have become indispensable for everyday, basic payment functions.

But depositing cash in a card is limited. Yet imagine what world of possibilities might open up if prepaid card technologies could be applied to the poor, unbanked segments of society.

IESE's Francesc Prior and [Javier Santoma](#) did a comparative study analyzing the development of prepaid systems in the United States and Europe. Their paper, "[The Use of Prepaid Cards for Banking the Poor](#)," recommends that stored-value cards could serve as the basis for a banking system that would not only allow for withdrawals, but could also provide microfinance services using cellular technology.

Classifying card payment systems

In order to understand card payment systems better, the way by which transactions are authorized and authenticated are classified into three categories.

1. The transaction is authorized using a line of credit, debit or the amount of e-money in an internal account (i.e., prepaid).
2. The transaction is only authorized when the acceptance network is online, or sometimes when the system is off-line.
3. The transaction is authenticated by inputting your personal identification number

(PIN) or by signing a receipt.

After credit and online debit cards, the most recent type of card to be launched in the United States and Europe is the stored-value card (SVC). These cards give users the same payment functions as online debit, but the transactions are not authorized by verifying the monetary value of the bank account linked to the debit card, but instead by the monetary value of the internal account that the prepaid card is linked with.

SVCs promise great potential for the poor, because:

- Customers using prepaid systems do not need a bank account, debit or credit cards.
- Users do not need to develop or invest in new technologies.
- This payment mechanism can be used with a number of platforms such as PCs, mobile phones, handhelds and set-top boxes.
- It is a payment system especially designed for micropayments, microdeposits and even microcredits.
- It allows users to control their cash flow by receiving statements or by accessing balances through PCs, mobile phones, handhelds and set-top boxes.

Prepaid industry in the United States

In the United States, SVC systems function in two ways. First is the closed-loop system, which can only be used for the issuers' products or for limited purposes, such as prepaid gift cards in a closed payment network. The other is the open-loop system, which provides consumers with multipurpose card functions, making purchases or paying bills. The open-loop system is currently used for debit and credit cards.

The open-loop SVCs can be grouped into three categories:

1. Payroll-only cards, which can be used only for direct deposit of paychecks or for receiving automated clearinghouse (ACH) deposits.
2. Reloadable payroll cards, which serve as direct deposit cards for paychecks, but also offer consumers other ways to reload them.
3. General purpose reloadable debit cards, which consumers can reload at a range of locations.

SVCs have the potential to be valuable for the unbanked population in the United States for many important reasons, including:

- The poor generally do not have the identification and credit requirements imposed by traditional banks.
- SVCs can be purchased and reloaded at a number of locations, not just banks.
- SVCs provide immediate availability of funds at a cost that is lower than alternatives.
- SVCs are difficult to overdraw, thus reducing the chance of unexpected fees.
- A large number of SVCs do offer remittances, allowing cardholders to transfer funds to authorized family members in other countries.

While the exact size of the SVC industry in the United States is not known, it is a growing one, with many of the major banks involved. If SVCs can successfully establish a method by which to offer savings and other benefits to previously unbanked customers, it would be a win-win situation for all.

Though some firms, such as Directo and NetSpend, have experimented with these features, finding the right formula is still a work in progress. For one thing, in order for SVCs to improve their savings or credit-building features, they would have to adhere to stricter identification verification, which is a turnoff for the unbanked population. In addition, the credit-reporting system and other regulations, such as the U.S. Patriot Act, raise additional challenges.

Prepaid industry in Europe

Prepaid electronic payments emerged in Europe around a decade ago. They were first introduced by non-banks, but shortly after, banks and the European central bank demanded measures to regulate the issuance of e-money. After a long, drawn-out process, a separate regulatory framework for electronic money issuers (ELMIs) was developed.

In Europe, prepaid cards are normally issued by traditional banking institutions, and consumer demand for these products has remained relatively low. While prepaid cards might seem the way to go for non-banked customers, such as immigrants, the high level of banking access throughout Europe has prevented this method from growing quickly.

All 25 member states have implemented the E-Money Directive (EMD), a protocol that defines and regulates e-money and e-money issuers. The EMD has been implemented by different national governments, and the variations created by the various implementations have created some legal uncertainty for issuers. Additionally, the EMD has serious problems of applicability regarding issuers such as mobile telecom operators, transport companies and electronic vouchers.

Contradictions must be worked out

While the idea of reaching the unbanked segment through pre-paid cards is a viable one, many challenges lie ahead. The United States market seems more relevant for this concept, with nearly 20 million U.S. households remaining unbanked. Europe, on the other hand, has financial services available to almost all its population.

By making prepaid cards or SVCs available to this segment, the government could be providing them with basic and valuable financial resources. However, in order to develop the products fully, they must offer credit and savings features, which alienate the very unbanked population they are trying to reach.

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