



# DISCUSSION PAPER

## PAYMENT CARDS CENTER

### A Prepaid Case Study: Ready Credit's General-Purpose & Transit-Fare Programs

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April 2012

***Summary:** Today, prepaid cards are used in dozens of payment applications. To examine the most recent developments, the Payment Cards Center of the Federal Reserve Bank of Philadelphia hosted a workshop on August 22, 2011. Leading the workshop was Tim Walsh, president and chief executive officer of Ready Credit Corporation, a firm that developed network-branded prepaid cards for use in transit-fare systems and also markets general-purpose, reloadable prepaid cards to consumers. Walsh discussed the unique opportunities and challenges associated with using prepaid cards for transit purposes. He described a model of customer acquisition that emphasizes direct advertising, high-quality call centers, and high rates of enrollment in direct deposit. Walsh compared and contrasted card usage patterns in his transit and general-purpose programs. He also described the importance of cost-effective messaging strategies that reduce program costs and teach customers how to reduce the fees they incur.*

Keywords: Network-branded prepaid cards, general-purpose, reloadable prepaid cards, electronic payments, payment cards, transit-fare payments  
JEL Classification Numbers: D14, D18, E42

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## **I. Introduction**

On August 22, 2011, the Payment Cards Center of the Federal Reserve Bank of Philadelphia hosted a workshop to discuss the role of bank-issued, network-branded prepaid cards in modern transit-fare payment systems and how the prepaid card platform is being adapted to meet the needs of transit agencies and their ridership. The workshop focused on the activities of one firm — Ready Credit Corporation — that offers consumers both general-purpose, reloadable (GPR) prepaid cards as well as prepaid cards adapted for use in specific transit systems. Tim Walsh, president and chief executive officer of Ready Credit, led the workshop.

The discussion during the workshop made it clear that the network-branded prepaid card platform can offer transit agencies substantial value. For example, these cards offer the opportunity to access cost savings and efficiencies associated with electronic payments and can be structured so that cardholders can access transit systems in a fast, efficient manner. In addition, adding acceptance of network-branded prepaid cards in a modern transit-fare payment system offers the option to replace proprietary fare media, which until now were the only means of serving transit customers who do not have credit or debit cards.

The workshop also included a discussion of Ready Credit's GPR prepaid card business model. As Walsh pointed out, this is a market that is still developing, and businesses such as Ready Credit are continuing to learn more about how consumers use their prepaid cards and what they want from their cards. One challenge for providers of GPR cards is that new customers may initially require a substantial amount of customer support. Providing this support affects the cost structure of prepaid card providers, but, if

done properly, it can also play an important role in attracting and retaining the most profitable customers. This has been the experience at Ready Credit.

The workshop presented an opportunity to compare two segments of Ready Credit's customers: those who obtain GPR cards and those who obtain Ready Credit's card, in part at least, to use on transit systems. Walsh noted that, while there are some differences, the spending behavior of these two segments is surprisingly similar. This is true for both where consumers spend and how much they spend.

Finally, Walsh described a recent messaging experiment designed to assist its customers to reduce the costs of using their GPR cards at ATM machines. He noted that the results of the experiment suggest that simple yet targeted messaging can have a meaningful impact on consumer behavior and the fees consumers incur.

This paper is organized as follows. Section II provides background information on prepaid cards. Section III describes how network-branded prepaid cards can be adapted for use in transit-fare payment systems, and details Ready Credit Corporation-provided network branded prepaid cards that can be used to pay for transit fares. Section IV addresses how Ready Credit acquires GPR prepaid cardholders and meets GPR cardholders' needs; it also presents a comparison of two segments of Ready Credit's customer base: those who use prepaid cards with a transit application and those who simply use the firm's GPR cards without transit applications. The final section concludes.

## II. Background

The market for prepaid cards is made up of many different product segments, each employing different business models and different economics.<sup>1</sup> But they all share at least one feature in common: Value is loaded onto the card before it can be used to transact.<sup>2</sup>

Prepaid card product segments can be differentiated in a number of important dimensions. Some cards are intended for general use, while others are designed for specific applications (e.g., gift cards, transit cards, health-care savings account cards, etc.). Some cards are accepted by one or just a few merchants (private label), while others can be used wherever a payment network-branded card (e.g., Visa, MasterCard, Discover, and American Express) is accepted. In the latter case, the network's brand logo typically appears somewhere on the prepaid card. One of the largest segments of the prepaid card market is the GPR prepaid card segment. GPR cards are network-branded prepaid cards that can be reloaded when funds are depleted.

In recent years, the general-purpose prepaid card has been one of the fastest growing consumer payment instruments. The Federal Reserve's most recent analysis of noncash consumer payment trends reported 1.3 billion transactions using these cards in 2009. Between 2006-2009, the number of these transactions increased by more than 60 percent a year, several times faster than prepaid cards as a whole (21 percent) or payment

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<sup>1</sup> For more information on the prepaid card market dynamics, see "Federal Regulation of the Prepaid Card Industry: Costs, Benefits, and Changing Industry Dynamics," pp. 16-19 & 23-28.

<sup>2</sup> For more background information on prepaid cards, see Mark Furletti, "Prepaid Cards: How Do They Function? How Are They Regulated?" Federal Reserve Bank of Philadelphia Payment Cards Center Conference Summary (June 2004); Julia Cheney, "Prepaid Cards: An Important Innovation in Financial Services," Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper (July 2006); and James McGrath, "General-Use Prepaid Cards: The Path to Gaining Mainstream Acceptance," Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper (March 2007).

cards in general (9 percent).<sup>3</sup> According to Federal Reserve estimates, the aggregate value of transactions on general-purpose prepaid cards in 2009 was \$43 billion. The value of these transactions has increased at an annual rate of 46 percent since 2006.<sup>4</sup>

### **III. Network-Branded Prepaid Cards and Transit-Fare Payment Systems**

Transit agencies around the country are redesigning their fare payment systems to accept bank-issued payment cards (including credit cards, debit cards, and prepaid cards) directly at points of entry or exit.<sup>5</sup> Such acceptance offers several distinct value propositions.<sup>6</sup> For example, electronic payment systems offer transit agencies cost savings relative to accepting and managing cash, a less costly alternative to maintaining aging proprietary fare payment systems, and the opportunity to capture more data on how their customers use public transit.

But for most transit agencies, there are some significant obstacles that must be overcome in order to accept bank-issued payment cards at points of entry or exit into transit systems (this is the “open acceptance” model). These include, for example, deciding with partners who will bear responsibility for fraud losses when real-time

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<sup>3</sup> The Federal Reserve System, *The 2010 Federal Reserve Payments Study: Noncash Payment Trends in the United States: 2006-2009* (December 2010), p. 17. The other categories of prepaid cards in the Fed’s taxonomy include private label and electronic benefit cards. A portion of the latter are also network-branded prepaid cards.

<sup>4</sup> The growth rate is calculated from statistics contained in a presentation by Federal Reserve Senior Economist Geoffrey R. Gerdes titled, “Volumes and Trends in Prepaid from the Federal Reserve Payments Study,” given at the Network Branded Prepaid Card Association’s Prepaid Forum (October 15, 2011), slide 16.

<sup>5</sup> See Philip Keitel, “The Electronification of Transit Fare Payments: A Look at the Southeastern Pennsylvania Transportation Authority’s New Payment Technologies Project,” Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper (April 2009), pp. 2-4, which reviews the payment instruments accepted by large transit agencies as well as initiatives to expand acceptance to include new or previously un-included payment instruments.

<sup>6</sup> See Keitel (April 2009), pp. 17-19, which discusses factors that motivate transit agencies to accept bank-issued payment instruments.

payment card authorization is not possible in the time required for a rider to pass-through a turnstile; for replacing proprietary fare collection infrastructure with systems that accept standard open payment methods; for ensuring interoperability between electronic payment system operating standards and transit-fare payment system operating standards; and for customer service–related issues.<sup>7</sup>

Moreover, a portion of transit riders in most American cities do not have access to either a bank-issued credit or debit card. This means that, unless an alternative product can be provided to these consumers by the payments industry, transit agencies must continue to offer some form of their own payment media and will continue to receive significant amounts of cash from these customers. And since a portion of the costs of issuing transit-fare payment media would continue to be borne by the transit agency as a result, the gains to transit agencies of moving to an open acceptance model for payment cards would not be as great. As Tim Walsh explained, this was the principal problem that Ready Credit set out to solve in 2005.

#### **A. The Needs of Transit Agencies**

As Walsh described, Ready Credit recognized that many transit agencies wanted to accept payment cards at points of entry or exit into transit systems. To do this economically and equitably, transit agencies need a way of offering a payment option to riders who do not have credit or debit cards. Ideally, transit agencies would want the capability to offer these consumers a compatible electronic payment instrument on the

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<sup>7</sup> See Philip Keitel, “The Electronification of Transit Fare Payments: Examining the Case for Partnerships Between Payments Firms and Transit Agencies,” Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper (April 2011), pp. 18-20, which highlights obstacles to bank-issued payment card acceptance for transit-fare payments.

spot.<sup>8</sup> In response to this demand, Ready Credit, in 2006, released the first network-branded prepaid card issuance system for transit agencies. At the center of this system is a kiosk called the ReadySTATION,<sup>9</sup> where consumers can instantly and anonymously obtain network-branded prepaid cards, reload cards, and check balances.

### **B. The Ready Credit Transit Product and Its Value Chain**

Walsh explained that Ready Credit prepaid cards obtained at ReadySTATIONS operate just like debit cards and can be used in modern transit-fare payment systems that accept credit or debit cards at points of entry or exit.<sup>10</sup> He noted, however, that compared with credit or debit cards, the value chain for network-branded prepaid cards is generally more complex, that is, because a number of additional, independent firms play distinct roles in designing, distributing, and supporting a prepaid card program. Walsh described the specific structure of the value chain of Ready Credit's transit model in some detail (Figure 1).

First, Walsh described Ready Credit's role as the manager of prepaid card programs, or simply as a "program manager." In this capacity, Ready Credit is in charge of (1) concept design, development, refinement, and implementation; (2) project planning, tracking, and correction; (3) network management; (4) system and location monitoring; (5) issuing necessary updates and tests; (6) managing and storing data and reports; and (7) working closely with transit agencies to ensure that the system works as planned.

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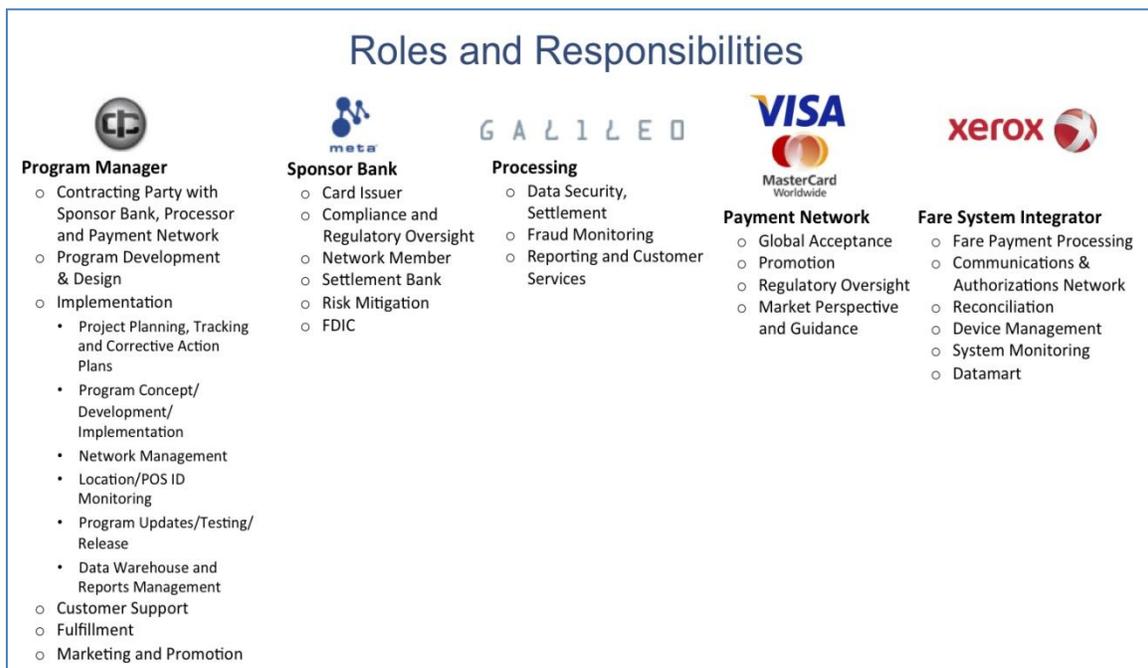
<sup>8</sup> Examples of traditional transit-agency-issued payment media and newer transit-agency-issued contactless payment cards are provided in Keitel (April 2009), pp. 30-31.

<sup>9</sup> Ready Credit was awarded a patent for the ReadySTATION in 2010.

<sup>10</sup> Modern transit-fare payment systems are transit-fare payment systems that accept payment cards for direct payment of fares. Please note that direct acceptance of bank-issued, network-branded payment cards is also known as "open acceptance" in the transit industry. See Keitel (April 2011), pp. 12-13, for more information about the open acceptance model.

In addition, Ready Credit has established a network of contracts — including contracts with a sponsor bank, a processor, payment networks, and a fare collection firm — that ensures its prepaid cards are compatible with the infrastructure that supports general-purpose payment cards. Depending on the arrangement between Ready Credit and a specific transit agency, Ready Credit may also be responsible for marketing and promoting the prepaid card, as well as for providing customer support.

**Figure 1 – Roles and Responsibilities of Firms in the Ready Credit Transit Card Value Chain**



Second, Walsh described the role of the sponsor bank, MetaBank. As Walsh explained, MetaBank (1) issues the prepaid cards; (2) is responsible for compliance and regulatory oversight; (3) maintains payment network membership; (4) acts as the issuing bank for settlement purposes; (5) provides mitigation from risk associated with payment clearing and settlement; and (6) complies with Federal Deposit Insurance Corporation

requirements for deposit insurance protection to be extended to underlying accounts.

Walsh noted that the issuing bank is integral to the operation of the system.

Third, Walsh reviewed the role of its processor, Galileo. He explained that the processor is responsible for maintaining and protecting the payment data needed for transaction settlement, for monitoring transactions to prevent fraud, and for providing certain reporting and customer services.

Fourth, Walsh discussed the role of payment networks Visa and MasterCard. He explained that Visa and MasterCard operate the networks over which the fare payment is authorized, cleared, and settled. He also noted that Visa and MasterCard have at times been responsible for promoting a program and/or providing guidance on important payments-related rules and regulations.

Lastly, Walsh described the role of Xerox, a company that provides technological and mechanical infrastructure and related services to transit agencies. Walsh noted that Xerox is responsible for creating much of the hardware that is used to process electronic transit-fare payments and for establishing the basic communication and authorization network at the transit agency. Xerox is also responsible for some of the recordkeeping in the system, ongoing management and maintenance of Xerox devices, and some system monitoring.

This collection of firms makes up the value chain for Ready Credit's transit product — a bank-issued, network-branded prepaid card issuance and acceptance system for transit agencies.

Walsh stressed that, even within his own business, there are significant differences in how his products are implemented at different transit agencies. For example, in one transit system, the Ready Credit cards may have two separate

applications — one for transit fares and another for general purchases at other retail locations. In another transit system, the Ready Credit cards may have only one payment application. Similarly, some agencies may seek transaction authorization on a real-time basis, whereas others may not.<sup>11</sup> Some transit agencies may want to offer automatic reload capabilities accessible via the Internet; others may not. Nonetheless, the basic product offered by Ready Credit is able to satisfy these requirements. It also leverages the flexibility and capability of the network-branded prepaid card platform.

### **C. Examples of the Ready Credit Systems Used by Transit Agencies**

Walsh described two implementations of its prepaid transit card program. The first is a partnership between Visa, Ready Credit, and the Los Angeles County Metro Transit Authority (LACMTA). The second is a program in place with the Utah Transit Authority (UTA).

In the LACMTA pilot program, Ready Credit offers a prepaid card product called the transit access pass (TAP) ReadyCARD.<sup>12</sup> The TAP ReadyCARD contains two separate payment applications. The first is similar to most Visa-branded credit and debit cards and can be used wherever Visa cards are accepted. The second payment application is designed to work specifically with the LACMTA transit-fare payment system. This is an example of a “hybrid” card in the sense that both general-purpose and custom-designed functionality (the latter for the transit application) are enabled on a single card.

Walsh explained that the TAP ReadyCARD offers cardholders access to the LACMTA system as well as the utility and benefits of electronic payments on a single

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<sup>11</sup> Transit applications pose special challenges to the usual real-time authorization of transactions that occurs in most card payment networks in the United States. For specific examples, see Keitel (April 2009), pp. 20-21.

<sup>12</sup> More information on the TAP ReadyCARD is available at: [www.tapreadycard.com/](http://www.tapreadycard.com/) (accessed October 4, 2011).

payment card, without requiring them to possess a line of credit or a demand deposit account. He noted that LACMTA demanded a solution that could provide its under-banked customers with a positive experience, since they would not be excluded from the modernization of their fare payment system.

For the UTA program, Ready Credit provided a somewhat different solution for transit riders without credit or debit cards. In 2009, the UTA launched the nation's first modern, open electronic transit-fare payment system that allows riders to use contactless payment cards to pay for rides when boarding transit vehicles. Ready Credit teamed with Xerox to adapt the ReadySTATION for outdoor placement. Four ReadySTATIONS, two placed outdoors near the UTA rail and bus entry points and two placed indoors in the bus terminals, vend contactless MasterCard-branded prepaid cards that function with the UTA system. As Walsh explained, the UTA example is the basic Ready Credit transit model at work.

#### **D. Challenges to Incorporating Network-Branded Prepaid Cards into Transit-Fare Payment Systems**

The network-branded prepaid card platform offers transit agencies the opportunity to fully realize the value of electronic payments and to discontinue issuing proprietary fare media. But there are challenges to the successful integration of bank-issued, network-branded prepaid cards into modern transit-fare payment systems. Five particular challenges were discussed during the workshop. These challenges include (1) legacy fare payment systems that are many years away from being fully amortized; (2) heterogeneity among transit agencies in regard to the design and age of their transit-fare systems; (3) problems associated with allocating responsibility in a multiparty system involving independent firms; (4) managing potential reputational risk that comes from tying

together different brands — transit agencies, banks, payment networks, and other providers; and (5) potential confusion among consumers about fees and customer support.

**i. Legacy Fare Payment Systems**

The first challenge is that many transit agencies already operate systems that allow riders to pay for rides using customized agency-issued prepaid cards (many of these now employ “contactless” cards, which can be more reliable than the older magnetic stripe-based systems). Some of these systems are relatively new and could be operated for many years. A transit agency with such a system may be reluctant to abandon it in favor of a new system that accepts network-branded payment cards, including prepaid cards. This might delay adoption of the open acceptance model among some transit agencies.

**ii. Heterogeneity Among Transit Agencies**

Walsh noted that immediate adoption of fare payment systems that accept bank-issued cards can be complicated by significant operating differences between existing transit systems and the more general retail payments infrastructure. This fact explains why some transit agencies may prefer to switch to hybrid cards first, since this move leverages their existing technology while offering riders a card with additional functionality that can be used at other retail locations. But this requires, as Walsh explained, cards that have two or more payment applications rather than one.

Walsh commented that having two payment applications on a single card is generally more costly and more difficult to manage than single-application systems. In order to offset those additional costs, program managers and card-issuing banks will want to identify and quantify the potential spillovers that such hybrid systems might produce.

For example, will the relationship with the transit agency generate nontransit spending on the cards that yields incremental revenues for program managers and/or banks? Will the transit-fare payment functionality make this card the consumer's favorite?<sup>13</sup> Will offering transit system functionality attract the kind of cardholders the program manager or card issuer seeks?

Walsh also observed that the operations of transit agencies vary widely. Transit agencies differ in the types of fare payment systems that they have or want, in the vehicles they operate, in their tolerance for absorbing fraud-related costs, in the ways riders use systems, and in rider demography. He noted that one or more of these differences can result in significant design differences for the underlying transit-fare payment systems — and for how network-branded prepaid technology might be incorporated.

### **iii. Allocating Responsibilities**

The third challenge observed was the set of complexities and intricacies that arise when multiple parties act in concert to offer a single product or service. Walsh noted that allocating responsibilities among parties, coordinating activities, and even communicating messages consistently can sometimes present significant hurdles, especially given the many parties involved in the value chain for network-branded prepaid transit cards. As he explained, the program manager acts as the central coordinator in the value chain and must actively manage the relationships among all the essential service providers.

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<sup>13</sup> This is sometimes referred to as a “top of wallet” effect and is one reason why rewards card programs are so popular among both issuers and cardholders.

#### **iv. Managing Potential Reputation Risk**

The fourth challenge addressed, although distinct, is also a result of multiple parties in the network-branded transit prepaid card value chain — it is the problem of managing reputational risk that comes from tying many brands together in such a scheme. In essence, a consumer who uses a network-branded prepaid transit card is likely to encounter the brands of at least three organizations: the transit agency, the bank issuer or the Ready Credit brand, and a payment network. If, for whatever reason, the user has a negative experience, this may influence how he or she views each of those brands. Brand-tying can, of course, have positive effects when things go well, or when a consumer holds a brand in high esteem. However, the phenomenon, at a minimum, exposes firms to the consequences of the actions of the other firms that are involved in a particular program.

#### **v. Potential Consumer Confusion**

The final challenge discussed is how to clearly explain to consumers that there may be multiple fee schedules that apply to a single product and how to resolve any consumer confusion that might arise. Walsh noted that, for products with multiple payment applications, there can be very different fee structures that apply to each application. This variation in fees is attributable to differences in costs associated with each application, but nevertheless they must be clearly explained to consumers.

In the LACMTA program, Walsh explained, it costs nothing to reload a card's underlying transit purse and no fees are charged in connection with the transit-fare payment system unless the card is used at a retail location. If this occurs, then fees may be charged for reloading the card or for using the card for transactions at other merchant

locations.<sup>14</sup> Walsh argued that reducing the learning curve and ensuring that consumers are aware of how and when different terms and conditions apply in a hybrid product is extremely important to the success of this program.

#### **IV. Consumer Demand for GPR Prepaid Cards**

Walsh noted that Ready Credit is not simply a firm that provides prepaid cards customized for transit applications. Indeed, many consumers who obtain a Ready Credit reloadable prepaid card do not use the card to pay for transit rides, nor do they use one of its transit-related cards primarily for transit purposes. Rather, cardholders use their cards to pay retailers for the purchase of goods and services in the same way credit or debit cardholders might. Walsh discussed how Ready Credit acquires GPR prepaid card customers and the types of services these cardholders seem to value. In addition, Walsh provided some descriptive information about how Ready Credit's GPR and transit customers use their cards. Finally, he offered some thoughts about fee structures and incentives in GPR card programs, as well as ways in which consumers can be helped to minimize their costs.

##### **A. Cardholder Acquisition**

Walsh explained that, from his perspective, a number of the early entrants into the market for general-purpose prepaid cards have succeeded in establishing a significant presence in specific customer acquisition channels. This "head start" conveys at least a temporary competitive advantage for those firms because it permits them to gain some

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<sup>14</sup> For example, at the time of the workshop, reloads of general-spending purses in the LACMTA pilot program cost \$2.00 at ReadySTATIONS, whereas no fees applied to reloads of transit-only purses.

scale economies. For example, Green Dot Corporation<sup>15</sup> has made significant strides in acquiring cardholders through retail channels, including partnerships with retailers such as Walmart. NetSpend Corporation<sup>16</sup> has made strides in acquiring cardholders through check cashing locations.

The customer acquisition strategy for Ready Credit is different, Walsh observed. Walsh explained that in addition to relying on the transit agencies to help acquire more customers, Ready Credit also uses direct-response marketing as well as advertising on television and through retail and online channels.

### **B. Services Valued By Cardholders**

Walsh described three general characteristics of Ready Credit's prepaid customers: (1) They value high-quality customer service provided through the call center; (2) they frequently use the Internet or mobile-phone-based applications to access their account information; and (3) they value direct deposit of their pay or recurring benefit payments into their accounts.

Walsh noted that the importance of call centers to Ready Credit's business model is an outgrowth of its customer acquisition model. Advertising on the Internet, television, and transit signage generates call volume by potential customers with little experience with general-purpose prepaid cards. The transit functionality on some of their cards and consumers' interest in direct deposit requires well-trained call center staff who are able to take time to work with these customers. In short, customer support resources are part of the acquisition channel; therefore, this justifies the additional resources devoted to customer support.

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<sup>15</sup> For more information on Green Dot, see: [www.greendot.com/greendot](http://www.greendot.com/greendot) (accessed October 7, 2011).

<sup>16</sup> For more information on NetSpend, see: [www.netspend.com/](http://www.netspend.com/) (accessed October 7, 2011).

Walsh noted that the call center can be an essential means of building a longer lasting relationship with the consumer. He argued that the importance of customer support to GPR prepaid card users should not be underestimated and that there is some indication that a high-quality call center can serve as a differentiator for consumers.

Second, Walsh observed that there is real demand among GPR prepaid card users for access to account information over the Internet or through the use of a mobile phone. He believes that robust mobile-phone-based tools will be a key part of supporting consumer relationships in both GPR programs tied to transit payments and in the regular GPR segment. From Ready Credit's perspective, the goal is to create tools that provide cardholders with greater ease of use and convenience because providing these services builds customer loyalty and may extend the period of time over which the card is used by the cardholder. It can also spare customer support resources for other needs.

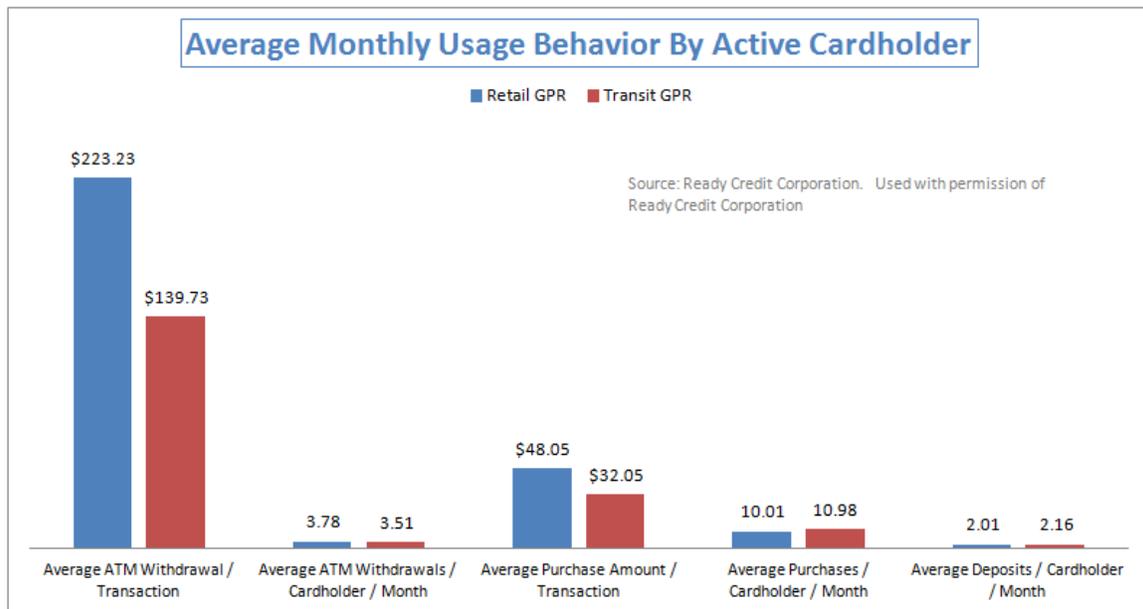
The third characteristic of GPR users that Walsh identified is a demand for the ability to receive direct deposit of benefit payments, typically government benefit payments, to the card account. Walsh observed that the GPR cardholder population his company attracts consists of many recipients of government benefits. Sixty-seven percent of ReadyCARD cardholders choose to deposit their benefit payments into their GPR card account. And cases in which these individuals are successful in doing so, Walsh provided the statistics of this greater stickiness — the average lifetime of direct deposit cardholders is 14.4 months compared with 6.2 months for cardholders who do not use direct deposit. Similar behavior has been documented for other GPR prepaid programs — prepaid cards

with regularly scheduled value loads are active for substantially longer periods and are used much more intensively by cardholders.<sup>17</sup>

**C. Use of Prepaid Cards by Ready Credit’s Transit and GPR Customers**

It is interesting to contrast the two types of consumers Ready Credit serves: those who use their GPR prepaid cards for general use and those who use their GPR cards with transit functionality. In this section, we will call the former *retail GPR* and the latter *transit GPR*. Walsh provided several examples of how these two groups of consumers use their cards. Although there are differences, they are not as great as one might expect. Some users of transit GPR cards indeed use these cards only for transit purposes, but many others do not. And among the latter group, their use of the cards in other retail environments is similar but not identical to the use of cards by Ready Credit’s retail GPR cardholders.

**Figure 2 – Average Monthly Usage Behavior (Transit GPR vs. Retail GPR)**



<sup>17</sup> See, for example, the presentation by Robert Hunt, et al. titled “Patterns of Consumer Use of Prepaid Cards,” which was given at the 3<sup>rd</sup> Annual Network Branded Prepaid Card Association Prepaid Card Workshop (October 5, 2011), slide 12. For more information, or to obtain a copy of the presentation, please contact the Payment Cards Center.

In general, there is more activity on retail cards, but in many dimensions the differences are not dramatic (Figure 2). One exception is the amount of cash withdrawn at ATM machines. A typical retail or transit GPR cardholder makes three to four ATM withdrawals per month, but the average amount of cash withdrawn by retail GPR cardholders is about 60 percent higher. Another exception is the average size of purchase transactions, which is about 50 percent higher among Ready Credit's retail GPR cardholders compared with its transit GPR cardholders.<sup>18</sup> By way of comparison, a Federal Reserve survey reported a \$33 average ticket for GPR card transaction in 2009.<sup>19</sup>

Both retail and transit GPR cardholders in Ready Credit's programs average about two deposits (value loads) every month. But there is a significant difference between these two groups in terms of the share of active cards with direct deposit. The average among active accounts in Ready Credit's traditional GPR programs is 82 percent. Among its transit GPR cardholders, direct deposit occurs on 37 percent of active cards.

There are many plausible explanations for the difference in the direct deposit rates in these two programs. In the final analysis, it appears that a large majority of Ready Credit's retail GPR cardholders view their cards as an important — if not their primary — transaction account. That is also true among at least a minority of Ready Credit's transit GPR customers. For the remaining transit GPR customers, direct deposit is either not as convenient a choice for them or perhaps they don't view this card as their primary transaction account. The similarity in the frequency of purchases, value loads, and ATM

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<sup>18</sup> This may be due to differences in the mix of transactions (see below) in these programs. Retail GPR cardholders have a higher share of transactions at merchant categories with higher average tickets (e.g., discount stores vs. fast food stores).

<sup>19</sup> See Gerdes (October 15, 2011), slide 17.

withdrawals among cardholders in the two Ready Credit programs suggests the former explanation should not be discounted.

**Figure 3 – Ready Credit Card Usage by Merchant Type (Transit GPR vs. Retail GPR)**

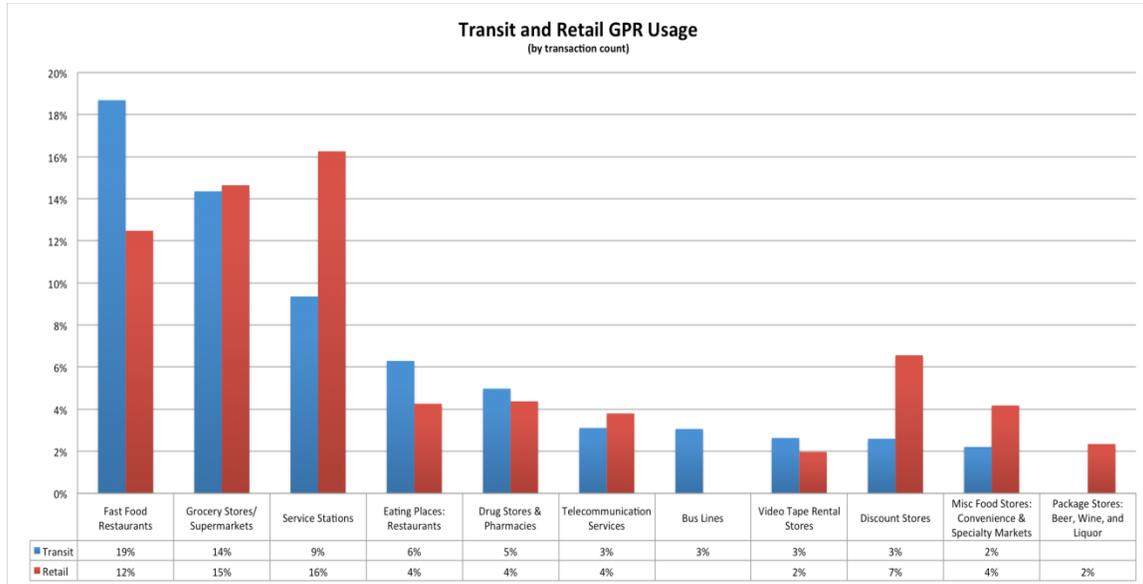


Figure 3 plots the share of transactions for different categories of merchants in Ready Credit’s retail and transit GPR programs. It is hardly surprising to find that the share of transactions spent on public transportation is higher among transit GPR cardholders than among retail GPR cardholders. Conversely, the share of transactions spent at service stations is higher among retail GPR cardholders than among transit GPR cardholders. Even so, these differences account for a small share (only about 10 percent) of total transactions on these cards.

There are some other interesting differences in the mix of transactions observed in these two programs. Spending among transit GPR cardholders is relatively more concentrated among restaurants and less concentrated among discount and convenience

stores when compared with the spending habits of retail GPR cardholders. On the other hand, the shares of spending at grocery and drug stores and for telecommunications services are practically the same in these two programs. In sum, while there are observable differences in the mix of transactions in these programs, those differences are not dramatic.

#### **D. Fee Structures and Incentives**

Walsh also discussed the relationship between program costs and consumer fees. He observed that the channel through which a cardholder is acquired can significantly affect the costs that a program manager or card provider experiences. Not only are some acquisition channels less costly, but some are stickier (cardholder use and retention are higher, resulting in the ability to recover costs over a longer timeline), and some acquisition channels have partners that help to defray costs. Walsh explained that in the transit-fare payment system context, for example, payment networks and transit agencies can have independent incentives to promote prepaid card use and can be willing to share costs associated with getting cards into consumers' hands. This is an example of the potential complementarities that arise from a judicious choice of partnerships.

Walsh also observed that cardholder behavior can have a significant impact on program manager's costs. For example, some cardholders are very heavy users of the company's call centers. He argued that, while it is important to answer consumers' questions and provide essential services, it is necessary for program managers to have policies in place to ensure that call center resources are allocated efficiently and equitably to customers. He also stressed that there are times when program managers can help consumers to develop behaviors that will limit the costs they incur. Walsh provided examples of both cases.

Walsh explained that, under most Ready Credit programs, cardholders can call live customer service representatives for free, four times per month (these calls are in addition to any calls about disputed transactions or instances in which there is an unusual situation). He noted that a very small share of cardholders call customer service four or five times a day, and a handful call as often as a hundred plus times a month.

Walsh described the incremental cost of a call center contact at Ready Credit. It costs Ready Credit about 90 cents per minute<sup>20</sup> to have customer service phone calls answered by a person. The average customer service call lasts about six minutes; therefore, the average cost of a customer service call is about \$5. Ready Credit charges a \$3 fee for calls with a customer service representative after the first four calls each month. In that case, the company will already have incurred about \$20 in costs and will continue to spend more on additional calls. Although this seems like a small amount, a typical GPR prepaid card yields between \$6 and \$14 in revenues every month.<sup>21</sup>

Another way of managing customer support costs is to provide ample access to automated means of obtaining basic information — for example, balance inquiries. Automated access is often more convenient for the customer and it spares call center capacity for more complicated inquiries. Walsh explained that Ready Credit plans to offer cardholders unlimited, free access to account information online and through interactive voice response (IVR) telephone lines, as well as through e-mail and text messages.

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<sup>20</sup> The \$0.90 per minute cost is the cost paid by Ready Credit for third-party customer service to handle customer service calls that overflow from Ready Credit–staffed customer services agents or during nonbusiness hours.

<sup>21</sup> See Hunt et al. (October 5, 2011), slide 17. Even among cards in the top fifth of revenues generated, median fee revenues per month (excluding interchange) were less than \$12. Even taking into account net interchange earned, revenues earned on a typical GPR prepaid card are still modest.

## **E. Helping Customers Reduce the Program Costs and Fees**

Walsh also described ways in which Ready Credit is able to assist customers to reduce the cost of using their cards. For example, the company observed that some cardholders were making several ATM withdrawals each week for relatively small amounts of cash (a few were withdrawing \$20 every day). Such behavior can generate a lot of ATM withdrawal fees or ATM surcharges.<sup>22</sup> In partnership with the Center for Financial Services Innovation (CFSI), Ready Credit conducted a trial experiment in early 2010 aimed at helping a sub-segment of its customer base reduce ATM fees. The company sought to find out if providing targeted advice via e-mail would have a positive impact on customers' financial behavior, demonstrated by a reduction in their ATM fees.

To begin their experiment, Ready Credit identified 232 customers who had accumulated \$25 or more in ATM fees for at least two months in 2009. These customers were randomly divided into two groups that received different tips on how to avoid accumulating fees in the future. The first group received notices encouraging users to check their balance online for free instead of performing balance inquiries at ATMs, an activity that results in a \$0.95 fee. The second group was advised to ask for cash back during retail transactions instead of incurring the \$1.95 fee that comes with withdrawing cash from ATMs.

Customers in each of the test groups received e-mail messages containing this advice once a week for three consecutive weeks. After sending the messages, Ready Credit tracked changes in ATM usage over a 12-week period for customers who opened the e-mail messages.

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<sup>22</sup> For ATM transactions, interchange fees flow from the card-issuing bank to the owner of the ATM. Issuers sometimes recover those costs by charging an ATM withdrawal fee for cash access at out-of-network ATMs.

The results of Ready Credit's experiment suggest that simple yet targeted messaging can have a meaningful impact on consumer behavior. On average, customers who opened at least one of the company's e-mails made 6.7 fewer ATM transactions and reduced their fees by \$11 a month. Additionally, Ready Credit conducted this experiment using its staff and pre-existing customer tracking tools, showing that measurable improvements in customers' financial behavior do not have to come at the expense of significant internal resources.<sup>23</sup>

Overall, Walsh observed that consumers who use transit GPR cards and retail GPR cards use their cards similarly when it comes to the types of merchants from which they purchase their goods and services, but somewhat differently when it comes to the types and value of transactions made in a given month. There are more significant differences in the ways these two customer groups use ATMs. He also noted that Ready Credit's cardholders have some identifiable characteristics, particularly when it comes to the card-related services they want, but that they can be heavy users of some costly card-related services. With regard to the latter observation, it is important for program managers or firms providing consumers with prepaid cards to have controls in place to limit costs.

## **V. Conclusion**

Prepaid cards are one of the fastest growing noncash consumer payment instruments in the United States today. Network-branded prepaid cards are clearly filling a niche among some consumers that traditional credit and debit cards cannot. The use of

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<sup>23</sup> "Can Email Alerts Change Behavior? An Experiment with Ready Credit Corporation," Center for Financial Services Innovation InBrief (June 2010); available at: <http://cfsinnovation.com/node/440544> (accessed March 19, 2012).

general-purpose prepaid cards for transit purposes is another example in which prepaid cards can satisfy a hitherto unmet need for consumers and merchants. This is an example of the relative flexibility of the prepaid platform.

The prepaid card market and, in particular, the GPR segment of the market, are not yet mature. As they continue to develop, there is much to learn about how consumers obtain and use cards and what they want from these cards. What is learned in these contexts will be important to determining how to best disclose information to consumers who use prepaid cards, how to positively influence consumer use and behavior, and how cost structures imposed by the industry can be viewed in relation to the underlying costs they recover and the incentives they may provide.