

Reaching the Unbanked with Stored Value Cards



Most Americans give little thought to the narrow brown stripe on the back of credit, debit, ATM, and retail gift cards. But those stripes, along with the underlying electronic networks that track debits and payments, have transformed banking, consumer credit, and retail sales over the past 20 years. Of the \$5.5 trillion that Americans spent on personal goods and services in 2001, 32% of those payments were made with credit or debit cards, up from 6% in 1984. For most middle-class consumers, magnetic-stripe technology offers yet more layers of convenience: a reloadable Starbucks card, 24-hour ATM transactions, or a quick fill at the gas pump. But for the estimated 20 million American households without a bank account, magnetic-stripe technology holds the promise of something far more important—a substitute bank account and a potential portal into the financial mainstream. With a relationship established between the issuing financial institution and the customer, the door is open for future savings and loan products.

In recent years, banks and credit unions have begun looking at stored value cards (SVCs) as a promising platform for offering unbanked consumers many of the same products and services associated with a traditional bank account, but at a much lower cost to financial institutions. Like debit cards, stored value cards use magnetic-stripe technology to store financial information and track funds, though their specific functions and flexibility depend on the kind of electronic networks and technology platforms that they use. To date, the principal innovations in the SVC market have emerged around mainstream consumer uses. From the retail gift cards offered by Macy's and The Gap, to the ubiquitous Starbucks card, the mainstream market for SVCs has exploded in recent years. MasterCard claims to have more than 200 SVC programs with about 100 issuers, and the company's relationships with third parties and processors have seen double-digit growth in the last few years. The Pelorus Group estimates that 15 million pre-paid debit cards were issued in 2003 alone. SVCs are also an increasingly common platform for delivering public benefits:

CHAPTER SUMMARY

PRODUCT/STRATEGY DEFINITION—Stored value cards use magnetic-stripe technology to deliver bank-like services (online purchases, ATM/debit transactions, point-of-sale purchases, bill payment) to customers without bank accounts. SVCs can be a starter product that establishes a bank-like relationship with unbanked customers.

CRITICAL SUCCESS FACTORS —

- 🔌 **Develop or re-sell.** If institutions can achieve enough volume, SVCs are an attractive way to serve a new market; without volume and resources, institutions should consider re-selling third-party cards.
- 🔌 **Pricing.** SVCs have different opportunities to charge fees, so careful thought should be given to pricing for competitiveness, fairness, and profit.
- 🔌 **Migration strategies.** Institutions wishing to make SVCs part of their unbanked product mix need a clear strategy for linking this starter product to mainstream asset-building opportunities.
- 🔌 **Data mining.** Detailed information about how each customer uses the product will help identify customers likely to be a good fit for other products and services. For instance, customers who maintain a positive balance between pay periods may be a better risk for a starter credit product.
- 🔌 **Clear indicators of demand.** The target customers for SVCs are transactors who don't want, or can't have, depository products—immigrants, low-income people, and customers with spotty credit.

INSTITUTIONAL FIT—If there are compelling reasons for an institution to develop its own card, the institution must have the resources and capacity for product development, administration, and cross-marketing of other bank products. If not, institutions should consider re-selling third-party cards that meet an institution's limited needs and capabilities.

STORED VALUE CARD TYPES AND FEATURES

Stored Value Card Features and Capabilities	Closed Loop	Open Loop		
	Can only be used for the issuer's products or for limited purposes. Examples include the Starbucks card, or a Borders gift card.	Similar to a debit card but without a linked account. They allow a variety of uses, including bill-payment, ATM withdrawals, and point-of-sale purchases from grocery stores and other retailers. Open-loop cards can be branded or unbranded :		
		Unbranded cards are linked to point-of-sale and ATM networks and use PIN-based technologies for sales and withdrawals. Examples include grocery store PIN networks and public benefit cards	Branded cards carry the Visa, MasterCard, Discover, or American Express logo and use signature-based technologies that allow users to make purchases anywhere the brand is accepted—retailers, restaurants, auto-repair shops, online retailers, etc.	
Point-of-sale purchases	Yes Within issuer's network (can't use a Starbucks card at grocery store)	Yes Anywhere with PIN keypad or ATMs	Yes Anywhere with Visa or MasterCard logo	
Reloadable	Depends on issuer and type of card	Depends on issuer and type of card	Depends on issuer and type of card	
Direct Deposit	No	Yes Depends on set-up	Yes Depends on set-up	
Risk of Overdraft	None	None	Slight Depends on reconciliation	

As of 2004, all federal food stamp benefits were delivered via electronic benefits transfer cards.

As the markets and technology develop, stored value cards could also become a powerful tool for reaching the unbanked. In principle, financial institutions could use SVC technology to offer the unbanked customers the services they currently receive from non-bank financial-service operations—but at a fraction of the cost. Refillable, branded SVCs would function like a debit card, allowing customers to do almost anything they could do with a credit card: make purchases over the Internet, buy groceries, pay for car repairs. Customers could receive direct deposits, withdraw funds from ATM machines, conduct point-of-sale debit purchases from the local grocery store, pay bills online, and buy money orders from the post office. From

the customer's perspective, SVCs would function like a low-cost, stripped-down bank account, but with a lower risk of overdraft. But because SVCs are explicitly not depository accounts, their cost structure is much lower—an important distinction and competitive advantage over traditional entry-level retail banking products. With less overhead than regular bank accounts and a profitable fee structure, SVCs would offer financial institutions a viable, sustainable tool for serving the unbanked.

Over the past two years, a pair of RFSI institutions, University Bank in St. Paul, Minnesota, and Central Bank of Kansas City (Missouri), have emerged as innovators in serving the unbanked through stored value cards. Both institutions tried to create a “personal spend card”: a stored value card that combined the functions of the

single-purpose “silo” products that are typical in today’s market, while also retaining the ownership and administration of the account underlying the SVC cards (see sidebar). The rationale for the multi-purpose card is quite straightforward. If this product is to be an alternative to a checking account or ATM-enabled savings account, then it must have the same versatility and functionality.

The rationale for actually owning the card, and managing the underlying account, is a bit more complex. If successful, the underlying funds would bring more assets under management for the issuing institution. Owning the accounts also means the issuing institution could mine user data, allowing cross selling and product development. Simply put, if you own the platform, it’s easier to link to other products. Car loan payments could be automatically deducted from a customer’s bank card.

At least that is the promise. As with any emerging technology, there are significant hurdles to be overcome. In practice, the providers of stored value cards are still a ways away from having the kind of fully integrated, re-loadable general spend card that the technology promises. There are regulatory issues that need to be resolved, and, as both banks discovered, credit card companies and third-party processors often complicate matters further. Nevertheless, both Central Bank and University Bank believe that this is the platform of the future, and were therefore willing to take risks and forge ahead so they could exploit new opportunities.

This chapter explores the institutions’ product development process—planning and product design, project management, relations with third party vendors, operations, product testing, pricing, and marketing—highlighting the salient lessons from their experience. As of this writing, both institutions are still in the pilot stage, but their experiences underscore the endemic challenges of being first movers in a new market. Both institutions struggled with emerging technologies, vendor relationships, and regulatory uncertainties that later entrants to the market will likely not encounter, at least not to the same degree. Yet they also gained valuable insights into their target market, SVC technology, and the process of product innovation.

The Personal Spend Card:

THE IDEAL STORED VALUE CARDS

University Bank and Central Bank both wanted a deceptively simple product: a stored value card that has the flexibility of a credit card, the functionality and consumer protections of a bank account, and the convenience of cash. But those characteristics did not exist in a single product, so they sought a composite product by fusing different types of stored value cards, complex banking networks, infrastructure, and functionality. The ideal product would have the following features and conveniences:

- ☛ **Built-in overdraft protection.** Like a debit card, purchases and cash withdrawals would come from a known positive account balance, minimizing the risk of overdraft.
- ☛ **Lower identification requirements.**
- ☛ **An entry-point into the financial mainstream other than a bank account.** SVCs are a good starter product for customers who don’t want a traditional bank account.
- ☛ **The instant-cash convenience of a check-cashing outlet.** Customers could walk in with a paycheck and walk out with the plastic equivalent of cash—at a lower cost than traditional check-cashers charge.
- ☛ **Bill Payment.** Using the bank’s electronic payments capabilities, SVCs offer a good, low-cost alternative to checking accounts or money orders.
- ☛ **Reloadability.** SVCs offer a flexible, convenient platform for reloading funds at retail money-service businesses, through direct deposit and electronic funds transfer, or through payroll deposits.
- ☛ **Remittances.** For the burgeoning immigrant market, SVCs offer a safe, convenient alternative for making remittances to friends and families in other countries.
- ☛ **Retail purchases.** Branded cards allow customers to make purchases anywhere the card logo is accepted.
- ☛ **Credit-building.** If linked to overdraft protection or a line of credit, SVCs could offer an opportunity to build or repair credit history, though credit bureaus would need to change their reporting guidelines to allow SVC data.

Source: PULSE EFT Association

Product and Strategy Design: In Search of the Personal Spend Card

University Bank:

Building a Bridge Product for the Unbanked

Over the years, University Bank in St. Paul, Minnesota, has developed a deep knowledge of the unbanked market. University Bank's staff reflects the demography of the neighborhood, so customers feel comfortable banking there. The bank is also centrally located, accessible to both foot traffic and public transportation. Yet one of the greatest challenges has been developing products for low-income customers, few of whom qualify for conventional banking products. For customers living paycheck-to-paycheck, the most important feature of their financial life is getting access to cash at the lowest possible price.

Hence, the proliferation of check-cashing outlets in the bank's neighborhood. In 1996, University Bank had five check-cashing stores within a six-block radius. The check-cashers were doing a brisk business, but David Reiling, University's chairman and president, thought the bank could offer better products at a lower cost while also moving the check-cashing customers into a banking relationship. In 1996, University Bank bought one of the check-cashing companies and moved it into the bank's lobby on the teller line. In just two-and-a-half years, the University Bank has moved over 100 check-cashing customers into savings accounts.

But the bank also realized that not all of its check-cashing customers wanted or could qualify for a bank account. Some didn't like the rules and fees, others didn't trust banks. Some couldn't manage a bank account and others simply didn't want one. Furthermore, only 20% of the bank's walk-in customers were able to meet the bank's minimum requirements for opening an account. How could University Bank develop a profitable relationship from prospective customers who, even under the best circumstances, would likely carry low balances and be high-volume transactors?

In 2002, University Bank began developing its stored value card, which aimed to give customers a banking product that combines the retail features of a bank account—a place to keep money, the ability to withdraw cash, make electronic payments, debit purchases—with the benefits of a credit

card—retail and online purchases, flexibility, the absence of cash—but without the risks associated with either one.

"We really wanted to design a product that is lower cost than a check casher but functionally similar to a bank account," Reiling says. "The idea was to use technology in order to take unbanked customers from a check-cashing model to something much closer to opening a bank account." Once customers had established a relationship with University Bank and had accustomed themselves to bank-like transactions through the SVC, Reiling hoped they would eventually move into a traditional banking account and on up into other financial vehicles. "We want this to be the first step on the road to asset development," said Reiling.

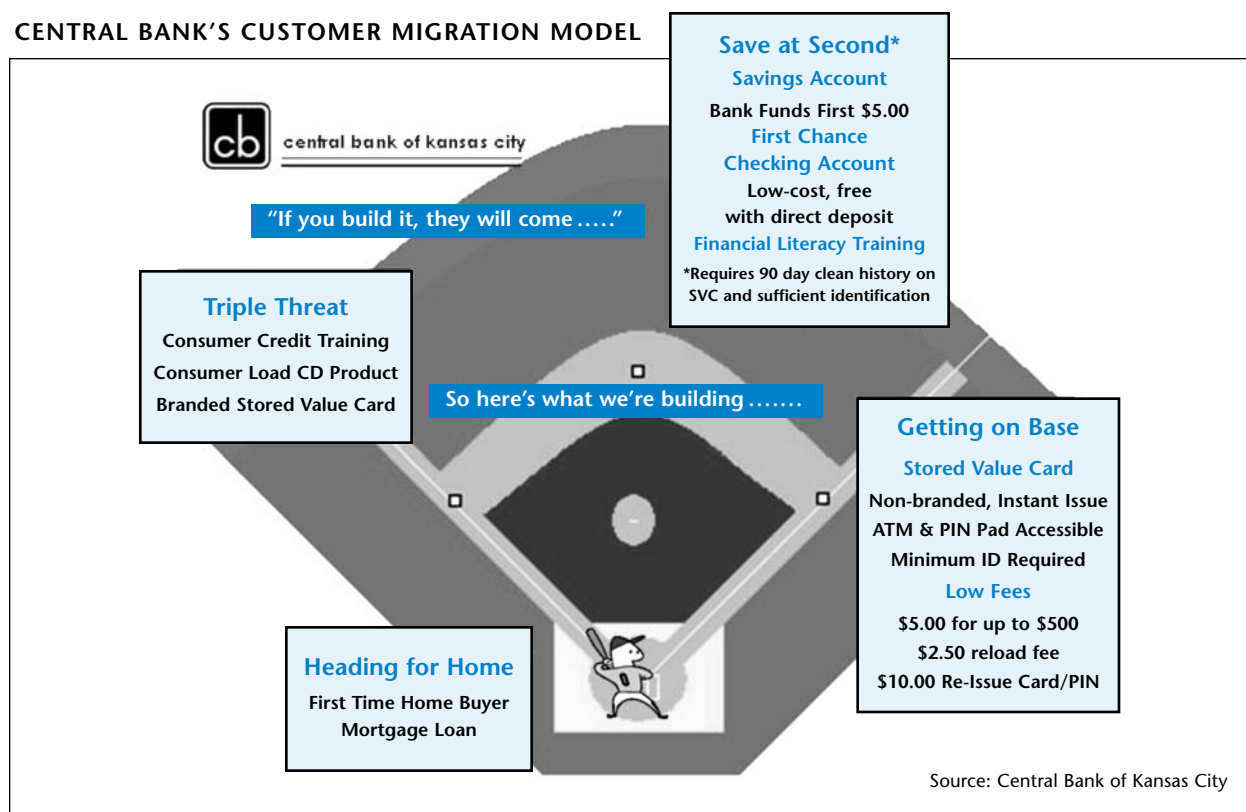
The bank has offered a non-reloadable gift card since November 2004, but it is waiting for the regulatory uncertainties to be resolved before developing a fully integrated general spend card.

Central Bank of Kansas City: Innovation in Retail Banking

Chartered in 1950, Central Bank of Kansas City has retained a strong focus on retail banking for over a half-century. With \$134 million in assets and eight locations throughout the Kansas City area, Central Bank serves largely low- and moderate-income households, with 25% of residents below the poverty line. For most of its history, Central Bank has focused on Kansas City's urban core. But Kansas City's demographics have changed, becoming more suburban and adding a sizable Latino population. Over the years, Central Bank has seen the number of accounts shrink as the market for retail banking shifted. The bank has responded by adding seven new account profiles and adding new banking products, including a new stored value card. As CFO Tom Lilley notes, "When you're in a non-growth market, it's hard to turn anyone away. We want to be in a position to do business with anyone who comes in."

Central Bank's stored value card strategy was developed mainly as an entry point for the unbanked, with a special focus on the growing Latino market. Lilley points to three reasons that potential customers are unbanked: identification issues, no credit or banking history, or a bad credit or banking history. With the potential for reduced

CENTRAL BANK'S CUSTOMER MIGRATION MODEL



ID requirements, stored value cards are an attractive option for immigrants, many of whom balk at stringent identification requirements, even when they have proper documentation. For those with no banking history or a history of poor account management, stored value cards make it harder to overdraw an account, adding a level of safety for the customer and the financial institution.

Lilley uses a baseball metaphor to describe how unbanked customers enter the financial mainstream by "getting on base" with a stored value card—and then advancing along the bases toward asset development.

Central Bank began developing its stored value card in 2003. As of April, 2005, the bank had issued 100 branded, open-loop cards, 50 of which were still active. Most have been used like gift cards—customers load them up and use them to make purchases at local retail outlets. In the coming months, Central Bank hopes to roll out a branded card with the functionality of a personal spend card, but the bank is still working out the kinks. Though the exact structure has yet to be determined, the new card will also have a remittance feature, allowing immigrant customers to send money back to friends and family in their home countries.

Product Development: Managing Vendors, Reaching Across Product Silos

While University Bank and Central Bank were both savvy enough to see the possibilities inherent in stored value cards, neither institution anticipated how difficult product development would be. In theory, the technology is capable of supporting the kind of user-friendly, flexible, multi-functional general spending card that University Bank and Central Bank want to offer. The reality, however, is a bit more complicated. Integrating the various systems and networks has proved to be a daunting task. Visa and MasterCard, the principle issuers of SVCs, offer a variety of cards—gift cards, payroll cards, general purpose reloadable cards—but they all have slightly different fees, limitations, operating structures, and, most important, functionality. Different functions are separated into product silos, meaning that a payroll card is different from a gift card, which is distinct from a general purpose card. A payroll card, for example, can only be reloaded through direct deposit, not at a teller window or corner store. And a gift card can't be used for remittance payments. The upshot was that stored value cards worked great as long as they were used in the right product silo.

Most of the responsibility for integrating these functions fell to Pulse EFT Association, the third-party vendor that both banks selected to manage the underlying electronic network and operations. Based in Houston, Texas, Pulse offered a turnkey solution that allowed the banks to plug into an existing electronic funds network, account-management platform, product line, and customer service—while the banks held the underlying assets and managed retail customer relations. When a customer called the toll-free customer-relations number, Pulse routed the number to the financial institution. Pulse’s pricing was also much lower than their competitors’. Central Bank spent about \$6,000 on set up; monthly expenses run between \$250 and \$400. (By contrast, Pulse’s closest competitor charges \$6,000 per month for similar services.) Despite Pulse’s price advantage, however, the company lacked some of the operational expertise needed to integrate the various card functions. For instance, when Central Bank tried to have a customer’s Missouri state tax refund loaded onto a SVC, it took Pulse a long time to prepare all the correct agreements. Then, once the transaction was ready to go, the company neglected to notify the Federal Reserve Board’s ACH area, so the refund was disqualified and sent back to the state.

Both institutions struggled with internal project management. When University Bank started researching SVCs three years ago, Reiling was the champion and chief visionary. As the bank grew, Reiling had to pass off some of his duties to subordinates, who lacked his authority and understanding of the product. When product development ran into obstacles, for example, no one had his executive authority to telephone Pulse’s CEO and get to the bottom of things. “You really need a senior person driving a project like this,” Reiling says. “They have to understand the technology soup to nuts, but also the what, how, and why you are developing it.” Project management requires a deft blend of strategic vision and attention to detail—someone who can see the big picture but also parse the details of a vendor contract. Lilley echoed these sentiments, noting that Central Bank would ideally have had a full-time project manager to oversee product development and marketing. “This is not the only thing we do. It’s piled on top of everything else that has to happen on a daily basis.”

**Pricing and Regulation:
Into the Great Unknown**

The other main obstacle was the ongoing uncertainty around pricing and regulation of stored value cards. Stored value cards are fundamentally transactional products that generate revenue from fees. The pricing structure of stored value cards varies widely among issuers, both banks and non-banks. University Bank’s gift card cost between \$6.95, \$8.95, or \$10.95, depending on the value (\$10-\$500); Central Bank’s card was \$5 to load (up to \$500) and \$2.50 to re-load, but there were over a dozen potential fees for transactions including funds transfer, lost card processing, and bill payment.

The banks themselves faced a host of fees from their vendors—foreign ATM fees for remittance transactions, for instance—and difficult economies of scale. “If you are going to do everything—take the money in, provide backroom customer service, and manage the program—it’s going to be tough to make money,” Reiling says. Financial institutions may be able to cut costs by working with large employers and having direct deposits on payroll cards, but even the largest institutions are struggling to find a profitable scale.

INDUSTRY STANDARD STORED VALUE CARD PRICING

Function	Price
Card issuance	\$1.00 — \$9.95
Card re-load	Free — \$5.95
Card re-issuance	\$1.00 — \$9.95
Monthly maintenance	Free — \$3.00
IRVU	\$0.50 — \$1.00
ATM	Free — \$2.00
Bill payment	\$0.50 — \$1.50 per transaction
Dormancy Fee	\$5.00 — \$15.00
Activity Statement	\$10.00 — \$25.00

Source: University Bank

Meanwhile, bank regulators are just now discussing how SVCs should be categorized and regulated. The regulatory confusion is due in large part to their complex hybrid form and function. If measured by their functions and capabilities, stored value cards look very much like a bank account. Customers can make ATM withdrawals, conduct PIN-based transactions, and make “deposits” on an account with a known positive balance—functions that are fundamental to bank accounts. Yet the underlying network architecture is very different. In most cases, banks hold funds in a pooled account, either on or off the institution’s balance sheet, though some banks link cards to individual accounts and sub-accounts. This architecture drastically reduces the cost of account maintenance, but also frees SVCs from the regulatory burdens associated with demand depository accounts.

Are SVCs demand deposit accounts, or are they something else? Federal regulators are currently wrestling with this question, and their determination will have profound implications for the future of the SVC market. If regulators rule that SVCs are demand deposit accounts, the cards will be subject to FDIC insurance (a boon to customers) and a host of accompanying regulations—Patriot Act identity requirements, Regulation E, CIP, OFAC, ChexSystems, privacy statements, and so on—all of which would upend SVCs’ lower cost structure. On the other hand, such a ruling would likely eliminate some non-bank competition among check cashers and pawn shops.

Then there are state regulators. During the 2005 session, Minnesota legislators considered a bill to ban some types of fees on stored value cards—a move that would have essentially legislated SVCs out of existence. Legislation in other states differentiates between store gift cards and other kinds of SVCs. Advocates point out that there are vast differences between bank-issued cards and those issued by non-bank vendors. A more nuanced regulatory approach—banning certain types of fees, or fees on cards issued by certain vendors, or fees on certain types of cards—could eliminate the downsides of some SVCs while retaining the fundamental cost structure that makes SVCs such an appealing option for serving the unbanked.

Operations and Marketing: Product Roll-Out and Scaling Up

Despite these challenges, University Bank and Central Bank have made steady progress towards the launch of an integrated general spend card. Both institutions began with a non-reloadable gift card, rolling it out to a small number of customers and adding services and functions by developing, testing, and tweaking products among the third party vendors’ product silos. And as Central Bank’s Tom Lilley points out, there were significant advantages to getting into the market early, despite the regulatory uncertainties and operational challenges. Stored value cards were a relatively new product when Central Bank started developing its product, and getting into the market early has helped the bank stake out a market niche that would have been impossible to claim if the bank had waited. “If we had stayed around and waited for them to decide the regulations, we wouldn’t be where we are now,” Lilley says. After all, pawn shops and check cashers, the main non-bank competitors, have been moving into this market, and by getting into the market early and developing their products, University Bank and Central Bank are now poised to compete head-to-head with their better-capitalized rivals.

The question is how they will compete. University Bank has scaled back its ambitions. As of this writing, the institution is focusing its short-term efforts on getting a payroll card—a reloadable direct deposit card that employers can use in lieu of payroll checks—up and running. (Payroll cards are one of the strongest offerings in Pulse’s product silos.) The bank will continue offering a gift card, but it will be closing down its internal gift card product and selling a third-party’s card instead, marking it up and turning a small profit on each card sold. Reiling says the bank will continue working towards a reloadable general spend card, but he is waiting until the regulatory uncertainties are resolved.

Central Bank is moving forward on parallel tracks. The bank is beta testing a payroll card, which is projected to be profitable out of the box. With an eye towards Kansas City’s burgeoning Latino community, Central Bank also hopes to integrate remittance functions into its SVC product, but entering that market will also be challenging. A few weeks before the bank was about to launch a major marketing campaign in partnership with a local Spanish-

language radio station, the bank received a cease-and-desist letter from the US Postal Service, which owned the trademark on “Dinero Seguro,”—part of the moniker that the bank was planning on using for its remittance card. While the bank had to drop the proposed name, it also added a new member to the marketing staff who has deep ties to the Latino community and will shepherd development from here on out.

For institutions considering making a play in the SVC market, perhaps the best advice is to wait. Federal regulators are expected to clear up many of the underlying regulatory question marks within a year’s time. “From an entrepreneurial standpoint, there’s just too much risk for too little reward,” Reiling says. In the interim, both Reiling and Lilley urge institutions intrigued by the SVC market to experiment with re-selling cards offered by third-party vendors. Outsourcing, they note, is an inexpensive, low-risk way for institutions to familiarize themselves with card-based technology, operations, and the market in general. With operational systems in place and the regulatory issues resolved, stored value cards may well realize their full potential as a profitable transitional product for unbanked customers.

¹Jacob, Katy; Su, Sabrina; Rhine, Sherrie; and Tescher, Jennifer, “Stored Value Cards: Challenges and Opportunities for Reaching Emerging Markets,” (Chicago: Center for Financial Services Innovation, 2005). Ibid.