

# payments system research briefing

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## Stored-Value Cards: A Card for Every Reason...

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In a fall 2003 *At Your Service* article the latest emerging payment product—stored-value cards—was discussed. At that time, the focus was primarily on how these new payment cards functioned, what their uses were, and what the perceived benefits were for the involved parties. The article concluded with the observation that it would be interesting to see whether this type of payment card would be as well received by consumers as credit and debit cards. Fast forward four years, and the answer is quite evident. Yes, stored-value cards have definitely “come into their own,” albeit to varying degrees depending on the category.

In general, the past four years have seen an increase in the use of payment cards of all types. However, everyone may not have access to the credit necessary for a credit card or the demand deposit account necessary for a debit card. But anyone with cash can easily obtain a stored-value card. And, to a growing degree, stored-value cards are being tailored to fit a range of needs and uses. Principal categories include gift cards, general purpose and payroll cards, and flexible and health spending account cards.

### Gift Cards

Stored-value cards are now among the most frequently given gifts. After diamonds (and perhaps a 42” flat panel television) nothing says “Thinking of you...” like a gift card. Today, a gift card can be purchased for just about anything—groceries, gas, jewelry, coffee, or tools. TowerGroup estimated that more than \$80 billion was spent on gift cards in 2006. Of that, nearly \$60 billion was estimated to be spent on closed-loop cards, which are accepted by a specific merchant or group of merchants. Sales for retailers accounted for \$29 billion, restaurants/fast-food for \$18 billion, and miscellaneous (gas, services, etc.) for \$12 billion. Another \$23 billion was projected to have been spent on open-loop general-purpose cards—cards that are accepted anywhere the network brand is accepted. And if a person happens to get a gift card they just do not want or cannot use, now there are Web sites that facilitate the sale, trade, or donation of gift cards.

Also, in addition to purchasing gift cards directly from your favorite retailer, gift card kiosks now are popping up in places such as local grocery, drug, and convenience stores. Companies

like Blackhawk Network, established by Safeway Inc. in 2001, are offering retailers the opportunity to set up gift card “malls” with branded retail gift cards and general-purpose cards. Participants include Barnes & Noble, iTunes, Starbucks, American Express, MasterCard, Visa, Major League Baseball, and the National Basketball Association.

Located conveniently near the checkout lane, a shopper can quickly make a selection from among a variety of card options, pay, and go. This eliminates the need to drive to a number of destinations to purchase cards of multiple types or from a number of retailers. When ready to use, the card can be activated by following the accompanying instructions, typically found on the back of the card.

So, what are the benefits to the issuers and the merchants? For the issuers of closed-loop gift cards, reduced transaction fees as compared to credit and debit transactions, expedited transaction time as compared to cash and check, and the opportunity for sales in excess of the value of the card are all benefits. Open-loop card issuers benefit from the fees that may be generated by the purchase of the cards, the use of the cards, and things such as balance inquiries, replacement of lost or stolen cards, or inactive balances. And for both, there is breakage, or the funds on the card that go unredeemed. TowerGroup estimates that of the \$80 billion in gift card sales made in 2006, \$8 billion, or 10 percent, will never be redeemed.

For companies like Blackhawk Network and for the retailers where their kiosks are located, gift card issuers pay a commission for the cards that are sold on their behalf. In addition, the retailer may benefit from increased traffic resulting from becoming a “one-stop shop” for a host of branded gift cards.

## General-Purpose and Payroll Cards

A second category of stored-value cards includes general-purpose and payroll cards. Although these cards are different—general-purpose cards can be purchased through a number of channels, while payroll card programs typically are established by employers—they share a number of features. Both cards are network branded and can be used at ATMs, the point of sale, and online. And, in addition to funding general-purpose cards with cash on hand, they also can be funded and/or reloaded

by payroll direct deposit. As a result, the line between the functionality of reloadable general-purpose and payroll stored-value cards is quite fine.

New card options offer a variation on a theme. Wal-Mart and GE Money recently announced their partnership to issue the Wal-Mart MoneyCard, a Visa-branded stored-value card. Consumers will be able to load the Money Card with up to \$3,000 of payroll or other funds at Wal-Mart stores or fund the card through direct deposit. In addition to being accepted almost anywhere the Visa brand is accepted, the card will offer ATM access and may also offer money transfer capabilities such as those traditionally available from providers like MoneyGram and Western Union.

First Data Corporation also recently announced two new agreements to offer a product they are calling the Money Network Pay Card. In conjunction with Coinstar, a provider of coin counting and stored-value and money transfer services, the Money Network Pay Card will be offered through select Coinstar kiosks. These kiosks will issue a STAR-branded prepaid debit card. The card will allow for ATM access; offer a check-writing feature; allow for direct deposit of payroll; and provide money transfer capabilities from the United States to Mexico and Latin America. Further, consumers can phone Money Network and upgrade the card to a reloadable personalized Visa-branded stored-value card. First Data also will partner with the Discover Network to offer a similarly featured Discover-branded payroll card.

The growing popularity of these new offerings is likely reflective of their potential as an alternative means of payment for the country’s estimated 80 million underbanked consumers. Without the benefit of a formal banking relationship, many consumers sometimes pay expensive fees for services like check cashing, money transfers, and money orders to pay bills. For the users of general-purpose and payroll stored-value cards, there is an opportunity to reduce such fees.

Further, these cards offer consumers benefits that are not received when cash is used. For example, both cards enable consumers to receive a replacement card if their card is lost or stolen. Additionally, with payroll stored-value cards, the

underlying account that funds the card may be insured by the Federal Deposit Insurance Corporation. Also, general-purpose cards provide a balance inquiry feature typically for a fee. Because payroll card accounts are covered by Regulation E, the financial institution where the funds are held must provide the account holders a means by which they can receive information about their transaction history and account balance.

For employers, payroll stored-value card programs provide an opportunity to eliminate the expense associated with issuing paper checks to employees that do not have an account with a financial institution. According to the American Payroll Association, these costs are estimated to range from \$1 to \$2 to process, print, and deliver a check and up to \$9 to replace it if it is lost or stolen. Companies like FedEx, UPS, U-Haul, Manpower Inc., Automatic Data Processing (ADP), McDonald's, Denny's, Coca-Cola, Sears, and a host of others all participate in payroll card programs.

For issuers of general-purpose cards, the benefits align with those previously mentioned. In addition, the newly announced cards offer yet another means to convert even more cash payments to electronic, and thus create new fee revenue. Further, these cards are viewed to be a potential point of entry to introducing the underbanked population to the benefits of more financial services.

## Flexible and Health Spending Account Cards

A third category of stored-value cards is the flexible spending/health-care reimbursement card. These cards are a means of accessing funds contributed by employees to their flexible spending and health-care reimbursement accounts, which are typically offered as part of an employer-sponsored benefits plan. These accounts enable employees to contribute pre-tax income (up to certain limits) to cover eligible dependant care and medical expenses.

Typically, to be reimbursed for eligible expenses, employees must submit receipts after the expenses have been incurred. The card feature enables employees to access contributed funds via a network branded prepaid debit card as the expenses are being incurred. Earlier this year, the Network Branded Prepaid Card Association announced the results of a survey it conducted about paying for health care. Eighty-one percent of the respondents who had a prepaid health-care card reported being extremely or very satisfied with their flexible spending account, while only 66 percent of those without a card feature expressed the same. Further, 80 percent of the respondents indicated that submitting receipts to be reimbursed for flex and health spending account eligible expenses was overly cumbersome.

Several providers offer or have announced initiatives to introduce health-care payment cards. Among them is Cerner, a supplier of health-care information technology services. In partnership with First Data Corporation and UMB Bank, Cerner launched Healthe, one of the first combined health plan ID and payment cards.

For contributors to flexible and health spending accounts, the benefits are the convenience and time savings due to eliminating or reducing the need to request reimbursement. For the employer offering the plan, the benefit may be that the more convenient the process for the employee, the more likely he or she will be to contribute. And, ultimately, the employer and employee benefit from the reduction in taxable income as well.

## Conclusion

It is clear that stored-value cards are meeting a host of needs and addressing perceived voids in payments options. In so doing, stored-value cards have become an important and dynamic component of the payments landscape.

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