A teal-tinted photograph of the Federal Reserve Building in Washington, D.C. The building is a grand neoclassical structure with a prominent portico supported by tall columns. A flagpole with the American flag stands in front of the building. The sky is a pale blue with light clouds.

Report to the Congress on Government-Administered, General-Use Prepaid Cards

July 2013

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM



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Preface: Implementing the Dodd-Frank Act

The Board of Governors of the Federal Reserve System (the Board) is responsible for implementing numerous provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Dodd-Frank Act requires, among other things, that the Board produce reports to the Congress on a number of topics.

See the Board's website for an overview of the Dodd-Frank Act regulatory reform effort (www.federalreserve.gov/newsevents/reform_about.htm) and a list of the implementation initiatives recently completed by the Board as well as several of the most significant initiatives that the Board expects to address in the future (www.federalreserve.gov/newsevents/reform_milestones.htm).

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Executive Summary

Section 1075 of the Dodd-Frank Act, which added section 920 to the Electronic Fund Transfer Act (EFTA), requires the Federal Reserve Board to report annually to the Congress on the prevalence of use of general-use prepaid cards in federal, state, and local government-administered payment programs and on the interchange fees and cardholder fees charged with respect to the use of such prepaid cards.¹

Federal, state, and local government offices commonly use prepaid cards to disburse funds at a lower cost than checks (or paper vouchers or coupons) and to provide an alternative to direct deposit for payment recipients, especially those recipients who do not have bank accounts. Government offices contract with financial institutions to issue prepaid cards, disburse program funds, and provide customer service.

The Board collected 2012 data from issuers and government offices on programs using prepaid cards as one or the only method to disburse funds. Government offices reported on 218 programs (including large, previously unreported Social Security and veterans programs) and issuers reported on 559 pro-

grams.² Government offices reported disbursing more than \$1 trillion, 13 percent of which was disbursed through prepaid cards. Issuers reported collecting more than \$504 million in fee revenue during 2012—62 percent from interchange fees and 38 percent from cardholder fees.³ Issuers of prepaid cards collected an average interchange fee of 1.1 percent of the average purchase transaction value in 2012 for these programs, which is roughly equal to that collected by issuers for all exempt debit purchase transactions.⁴ Although the prepaid cards provided under government-administered programs usually offer cardholders one or more free automated teller machine (ATM) cash withdrawals, ATM withdrawal fees constitute more than 60 percent of all cardholder fee revenue that issuers collected in 2012. Customer service and account servicing fees constitute the next largest source of cardholder fee revenue, at 13 percent and 10 percent, respectively.

Background

The Congress began facilitating the use of prepaid cards for government disbursements more than two decades ago. In 1990, the Congress passed the Mickey Leland Memorial Domestic Hunger Relief

¹ Section 1075(b) – (d) of the Dodd-Frank Act amends benefits statutes such that electronic benefit transfer (EBT) cards issued in connection with the relevant program are not subject to the provisions of section 920 of the EFTA. The amended benefits statutes are the Food and Nutrition Act of 2008, the Farm Security and Rural Investment Act of 2002, and the Child Nutrition Act of 1966. Although EBT cards issued in connection with relevant programs are not subject to section 920 of the EFTA, the Board believes that it is appropriate to include in this report information about such EBT cards because they represent a significant portion of prepaid cards issued pursuant to government-administered programs.

A program is considered government-administered regardless of whether a federal, state, or local government office operates the program or outsources some or all functions to third parties so long as the program is operated on behalf of a government office. In addition, a program may be government-administered even if a federal, state, or local government office is not the source of funds for the program it administers. For example, child support programs are government-administered programs even though no federal, state, or local government office is the source of the funds.

² For the purposes of this report, “Social Security” includes Old-Age, Survivors, and Disability Insurance (OASDI) and Supplemental Security Income (SSI).

³ An interchange fee is any fee established, charged, or received by a payment card network and paid by a merchant or a merchant acquirer for the purpose of compensating an issuer for its involvement in an electronic debit transaction. 12 CFR 235.2(j). Merchant acquirers typically pass these fees on to merchants. So, interchange fees, in effect, become a cost to merchants and revenue to issuers.

⁴ The Board’s Regulation II provides that an issuer subject to the interchange fee standard may not receive an interchange fee that exceeds 21 cents plus 5 basis points multiplied by the value of the transaction, plus a 1-cent fraud-prevention adjustment, if eligible. The interchange fee standards of Regulation II do not apply to the following types of debit cards: (1) debit cards issued by an issuer that, together with its affiliates, has assets of less than \$10 billion (“exempt issuers”); (2) debit cards issued pursuant to a federal, state, or local government-administered payment program; and (3) certain general-use, reloadable prepaid cards. 12 CFR 235.5.

Act, which allowed state governments to use prepaid cards to disburse funds under the Food Stamp program (now called the Supplemental Nutrition Assistance Program (SNAP)).⁵ In 1996, the Congress passed the Personal Responsibility and Work Opportunity Reconciliation Act, which, in part, mandated that state government offices disburse SNAP benefits exclusively through prepaid cards.⁶ More recently, some government offices have mandated use of electronic methods, including prepaid cards, for disbursing program benefits. For instance, as of March 1, 2013, the U.S. Treasury requires electronic disbursement, either by direct deposit or prepaid card, of Social Security, Veterans Affairs, Railroad Retirement Board, Department of Labor (Black Lung), and Office of Personnel Management funds.⁷

Today, nearly every state offers a prepaid card for child support, unemployment insurance, and Temporary Assistance for Needy Families (TANF) programs. Although many government offices continue to offer check payments as well, a number of govern-

ment offices now mandate that recipients receive payments electronically, either through a prepaid card or direct deposit.⁸ Additionally, several state and local government offices indicate that they plan to add prepaid cards as a method for disbursing tax refunds and other payments in the next few years. As a result, the share of government disbursements made through prepaid cards continues to increase.

Prepaid cards can be a convenient disbursement method and viable alternative to paper vouchers, coupons, checks, or direct deposit for payment recipients. Prepaid cards allow recipients to receive benefits without depositing checks into bank accounts. For recipients who do not have bank accounts, prepaid cards eliminate the need for recipients to cash paper checks and carry cash. Additionally, many issuers offer services to cardholders such as bill payment and mobile text or e-mail alerts that increase convenience and provide important information regarding the cardholders' accounts. Some issuers also offer a 24 hour customer service call center to cardholders receiving funds under certain programs.

⁵ Pub. L. 101-624, § 1729, 104 Stat. 3359, 3789-90 (1990).

⁶ Pub. L. 104-193, § 825, 110 Stat. 2105, 2324-36 (1996).

⁷ Financial Management Service (Treasury) Electronic Fund Transfer Rule, 75 FR 80315 (Dec. 22, 2010) (amending 31 CFR part 208).

⁸ Prepaid cards also have lower administrative costs—including printing, postage, and exception processing—for government offices than paper checks.

Survey Data and Results

The Board distributed one survey to 184 government offices to collect prevalence of use data and another survey to 14 issuers to collect fee data for programs that use prepaid cards as one or the only method to disburse funds in calendar year 2012.⁹ One hundred one government offices and all issuers responded. Government offices reported data for 218 programs and issuers reported data for 559 programs.¹⁰ These data represent programs from all 50 states and the District of Columbia.

Because of a significant increase in the number of and change in the composition of reported programs in 2012, many of the figures in this report are not comparable with corresponding figures in previous reports.¹¹ As the pool of reported programs stabilizes in future years, the Board intends to provide more general trends in these reports to the Congress

regarding the government-administered prepaid card market.¹²

The Board excluded programs that do not use prepaid cards from the universe of programs used to calculate prevalence of use and fee figures. Further, the Board used different subsets of the reported program data for each calculation in this report because a few survey respondents did not provide complete data. Where possible and useful, this report notes the number and type of programs included in a calculation.

Prevalence of Use

For calendar year 2012, 94 government offices administering 186 programs reported disbursing \$1.017 trillion to recipients, of which \$136 billion, or 13.4 percent, was disbursed through prepaid cards.¹³

Total funds disbursed and the proportion of funds disbursed through prepaid cards varied widely by program type, as shown in [figure 1](#). The Social Security Administration disbursed more than \$770 billion under Social Security programs, but it disbursed only 2.4 percent through prepaid cards. Similarly, government offices disbursed less than one percent of reported payroll and veterans' programs funds through prepaid cards.¹⁴ In contrast, state government offices distributed more than \$75 billion under the SNAP program, all of which was distributed

⁹ In preparing the 2012 surveys, the Board slightly revised the format of and questions in the 2011 surveys. First, the Board included a list of check box options in both the survey of issuers and the survey of government offices to help determine the types of programs on which respondents reported and to facilitate the grouping of programs during data analysis. Second, the Board removed from the survey of issuers questions regarding the maximum and minimum fee charged for each type of cardholder fee. The survey instruments are available at www.federalreserve.gov/paymentsystems/payres_papers.htm. The Board identified issuers to survey by consulting with relevant payment card networks.

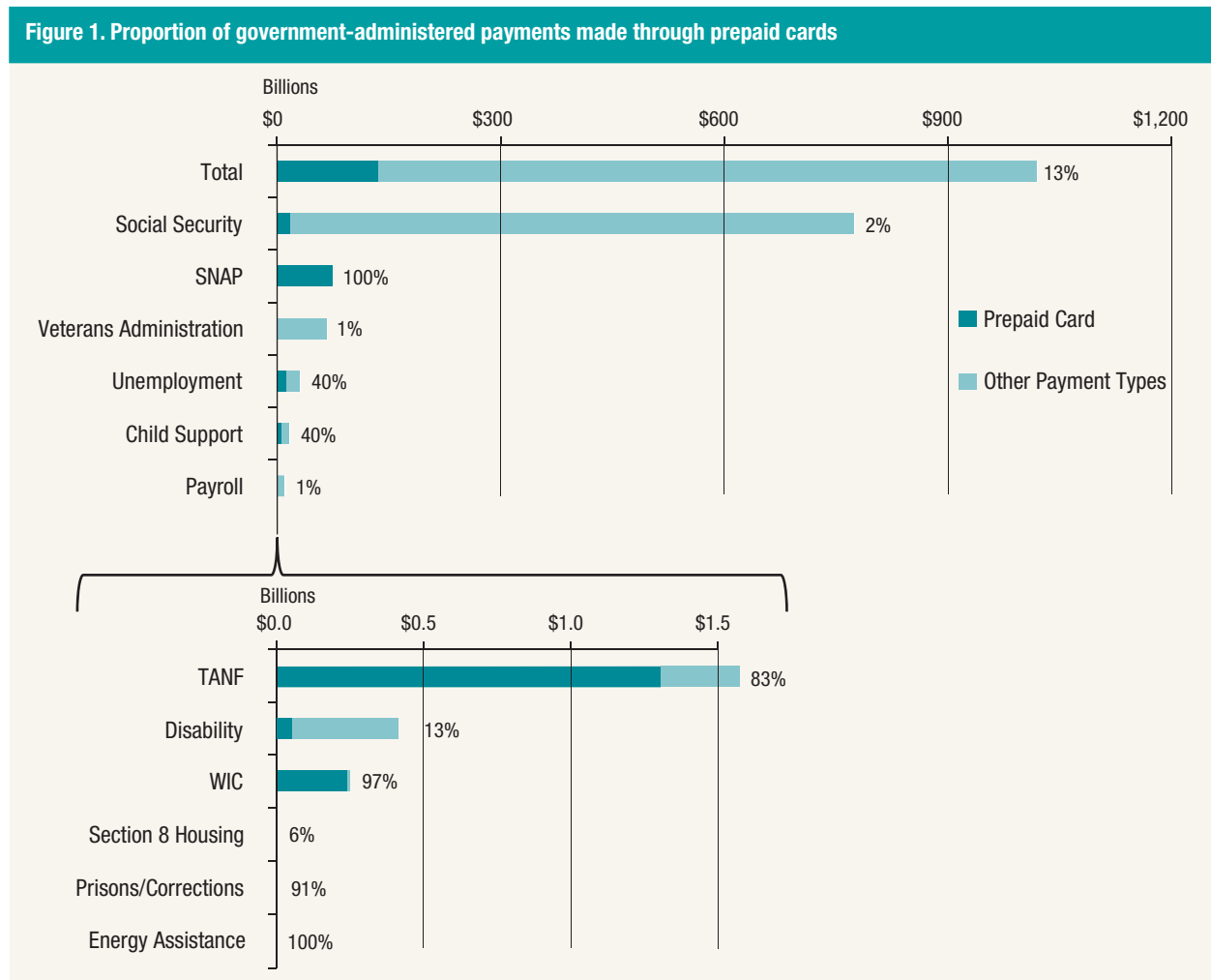
¹⁰ Survey respondents did not always list the programs covered in their responses. The Board only counted programs that it could clearly identify from each response. As a result, the program counts in this report represent lower-bound approximations. Data for three programs are not used in most calculations in this report because the survey responses were incomplete. These three programs consist of 410 individual penal institutions and represent only 0.07 percent of total funds distributed through prepaid cards as reported by issuers.

¹¹ There was a significant change in the pool of reported programs in 2012. For example, the Board received for the first time in 2012 prevalence-of-use data for programs administered by the Social Security Administration and the Veterans Administration. These offices represent several high-value programs that collectively disbursed over \$800 billion in payments.

¹² The Board's previous reports to the Congress on government-administered, general-use prepaid cards are available at www.federalreserve.gov/paymentsystems/payres_papers.htm.

¹³ Programs included in these calculations are those for which government offices reported both total funds disbursed by all payment methods and total funds disbursed through prepaid card.

¹⁴ Some government offices reported aggregate data for multiple programs of different types (for example, unemployment insurance, TANF, and child support). Calculations by individual program type of total funds disbursed through all payment methods and the proportion of funds disbursed through prepaid cards exclude these responses because the data could not be disaggregated.

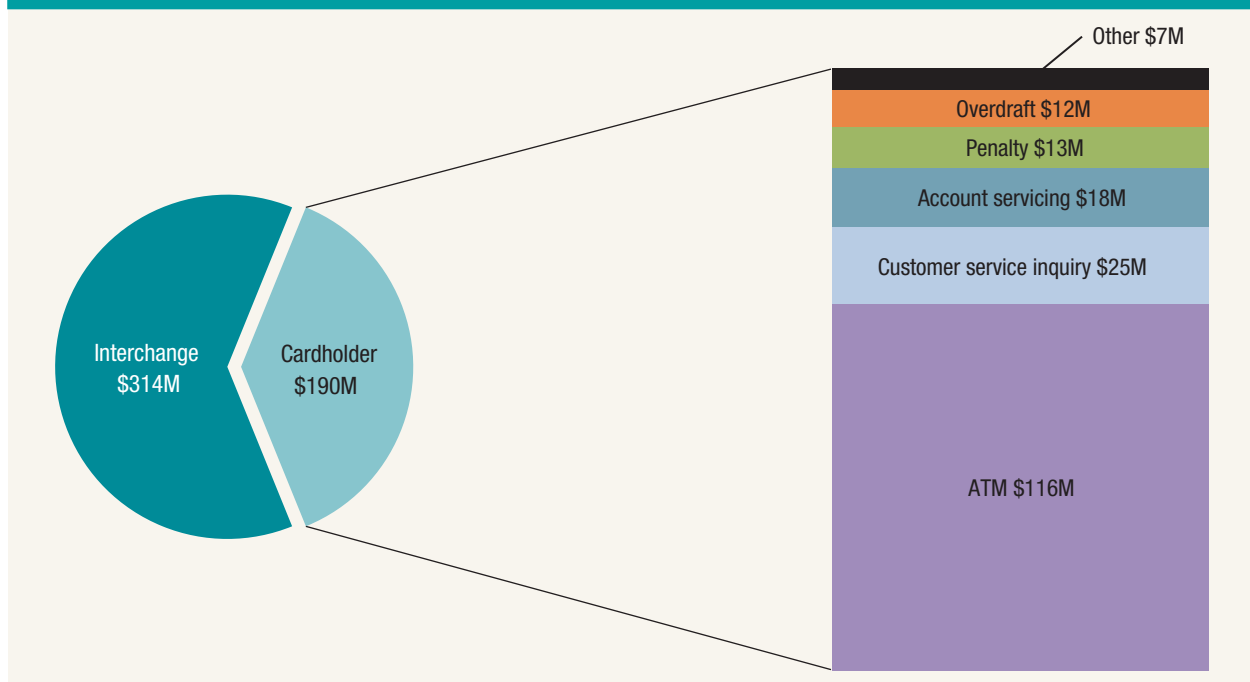


through prepaid cards. Other government offices also distributed benefits almost exclusively through prepaid cards under programs such as energy assistance, and the Supplemental Nutrition Program for Women, Infants, and Children (WIC).

The proportion of funds disbursed through prepaid cards increased in certain state and local program types. Unemployment insurance programs disbursed 40 percent of the \$37 billion in total benefits through prepaid cards, up from 37 percent in 2011. Similarly, child support programs disbursed 40 percent of \$17 billion through prepaid cards, up from 37 percent in 2011. These increases are consistent with the increased use by state and local government offices of electronic payment methods to distribute program funds.

Issuers anecdotally indicated that several factors influence the proportion of funds disbursed through prepaid cards under a given program. For example, legal, regulatory, or policy mandates to disburse funds electronically influence the use of prepaid cards (and direct deposit) to disburse program funds. The U.S. Treasury's recent policy of disbursing program benefits electronically may increase the proportion of Social Security funds disbursed through prepaid cards (and direct deposit) in future years. Issuers also indicated that use of prepaid cards as a method of disbursement may be more prevalent in programs with a large number of unbanked payment recipients, such as TANF. Additionally, for government offices that no longer use paper methods of disbursing funds, prepaid cards may be the sole method of disbursing program funds to restrict beneficiaries' use of

Figure 2. Issuer revenue by fee type



funds to certain types of goods and services, as is the case for SNAP and most WIC programs.

Fees Collected by Issuers

Issuers receive revenue from at least two sources: interchange fees and cardholder fees.¹⁵ In 2012, issuers reported collecting \$314 million in interchange fees and \$190 million in cardholder fees from 552 programs. Figure 2 illustrates the various sources of

revenue collected by issuers in 2012.¹⁶

Cardholder behaviors and program attributes can affect issuers' revenue. Cardholders who regularly use prepaid cards to make purchases at the point of sale generate relatively high levels of revenue for the issuer through interchange fees. Issuers anecdotally report that cardholders are more likely to use prepaid cards like a traditional debit card when a program involves regular disbursements over a long period of time (such as child support). These recipients are also more likely to use the prepaid card's service offerings that generate additional cardholder fee revenue. Conversely, cardholders who withdraw all or most disbursed funds from a prepaid card account in a single transaction at an ATM or over-the-counter (OTC) with a bank teller typically generate little revenue for the issuer. Issuers note that cardholders are more

¹⁵ Issuers may also collect management fees from government offices. Government offices and issuers indicated that such management fees are uncommon. In addition, issuers may collect revenue from payment card network incentives and interest on float. The Board does not collect data on these sources of revenue. Issuers sometimes enter into arrangements with third parties to manage customer call centers or provide other cardholder services, and may share interchange or cardholder fee revenue with third parties as compensation for their services.

¹⁶ Issuers reported complete interchange and cardholder fee data for the 552 programs used to produce figure 2.

Table 1. Average purchase transaction value, average interchange fees

	Average value of purchase transaction (dollars)			Average interchange fee per purchase transaction (dollars)			Average interchange fee as percentage of purchase transaction value (percent)		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Total¹	28.41	30.94	29.99	0.30	0.33	0.34	1.1	1.1	1.1
Federal	35.49	36.82	38.11	0.38	0.40	0.40	1.1	1.1	1.1
State and local	27.42	29.81	28.14	0.29	0.32	0.33	1.1	1.1	1.2
Signature	–	30.16	28.70	–	0.37	0.37	–	1.2	1.3
PIN	–	32.95	31.58	–	0.32	0.31	–	1.0	1.0

¹ Some program data reported in aggregate could not be allocated between federal and state and local programs. These data, however, are reflected in the total figure.

likely to withdraw all of their funds in a single transaction when a program involves frequent, low-value disbursements (such as weekly unemployment insurance), or infrequent disbursements (such as annual income tax refunds).

Interchange Fees

As shown in table 1, the interchange fees from prepaid card purchase transactions have been relatively stable since 2010 when the Board began collecting these data. Across all programs from 2011 to 2012, the average interchange fee per purchase transaction increased by one cent, while the average purchase transaction value fell by about one dollar. As a result of these changes, the average interchange fee as a percent of purchase transaction value increased marginally from 2011. Because the Board rounded the figure, however, the average interchange fee as a percent of purchase transaction value shown in table 1 remained at 1.1 percent for 2012. The average interchange fee as a percent of purchase transaction value remained at 1.1 percent for federal programs in 2012. It increased slightly to 1.2 percent for state and local programs in 2012, compared to 1.1 percent in 2011. Like other year-over-year comparisons in this report, the calculations of average purchase transaction value and the average interchange fee per purchase transaction are sensitive to changes in the pool of reported programs, which evolves from year to year.

The interchange fee standards of Regulation II generally do not apply to government prepaid cards. The average interchange fee as a percent of purchase transaction value for government prepaid card transactions is similar to the percentage for all debit card transactions exempt from the interchange fee caps of Regulation II that the Board reports in its study of

2012 average debit card interchange fees.¹⁷ In 2012, the average interchange fee as a percent of purchase transaction value for government prepaid cards was 1.3 percent for signature transactions and 1.0 percent for PIN transactions. The average interchange fee as a percent of purchase transaction value for all exempt debit cards was 1.4 percent for signature transactions and 0.7 percent for PIN transactions in 2012.

Cardholder Fees

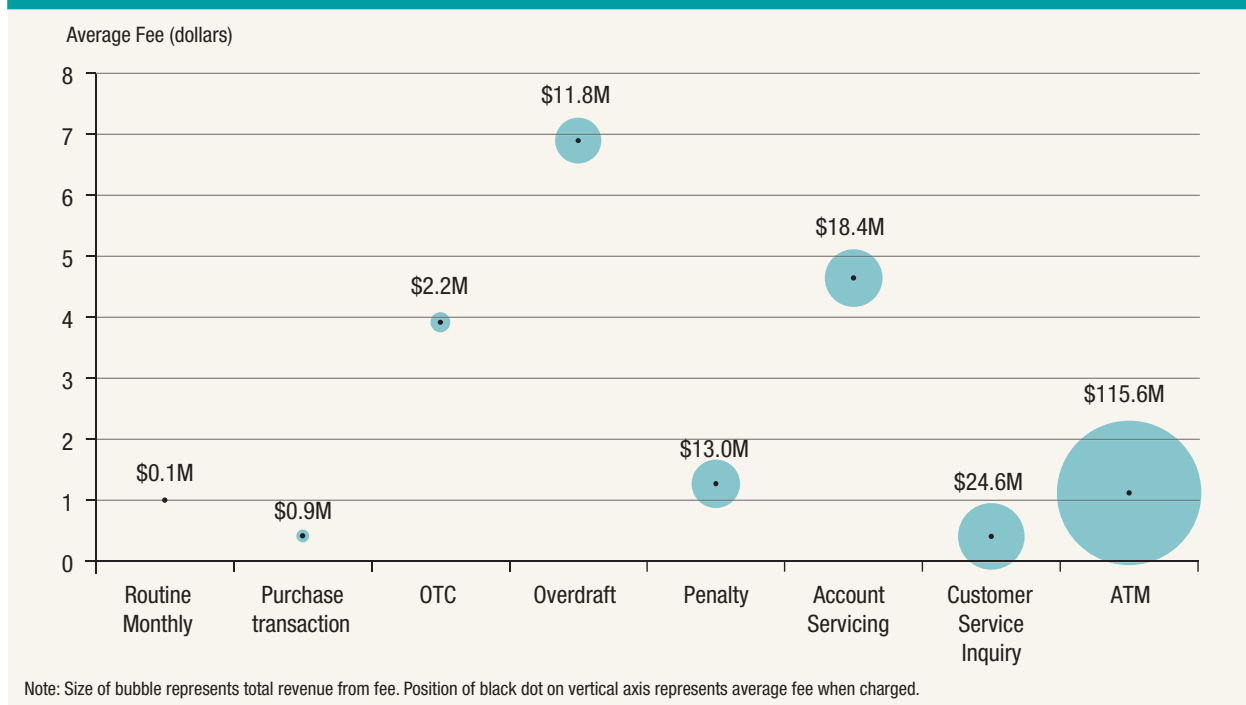
The data provided by issuers show that cardholder fee revenue as a percentage of program funds by prepaid card declined from 0.27 percent in 2011 to 0.26 percent in 2012. This decline is consistent with the anecdotal observations of some issuers and government offices that cardholder fees have generally declined over the past several years.¹⁸

Most government offices require issuers to offer cardholders a certain number of free ATM or OTC cash withdrawals and prohibit issuers from charging cardholders certain types of fees, such as monthly maintenance fees. Issuers may provide cardholders with more favorable terms than those mandated by government offices, such as unlimited in-network ATM and OTC withdrawals. Issuers rarely charge

¹⁷ Government-administered, general-use prepaid card transactions constitute approximately 8.5 percent of all exempt transactions. For more information, see the “Average Debt Card Interchange Fee by Payment Card Network” at www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm.

¹⁸ Consistent with previous reports, when calculating cardholder fee revenue as a percentage of total funds disbursed, the Board used all program data except SNAP. The SNAP program prohibits issuers from charging cardholder fees and is the second-largest reported program in terms of total funds disbursed by all payment methods.

Figure 3. Cardholder fees



purchase transaction fees and may waive cardholder fees under certain circumstances.¹⁹

Figure 3 illustrates the total revenue issuers collected and the average charge per occurrence by cardholder fee type in 2012. For each type of fee depicted in the figure, the size of the bubble represents the total revenue issuers collected while the position of the black dot along the vertical axis represents the average fee issuers assessed.²⁰ The Board excluded transactions for which no fee was assessed from the average fee calculations. In 2012, issuers collected \$115.6 million on ATM cash withdrawals, accounting for more than 60 percent of revenue issuers received from cardholder fees. The average fee charged by an issuer for an ATM cash withdrawal was \$1.12 per transaction. Customer service inquiry fees represent roughly 13 percent of total cardholder fee revenue, while

account servicing, penalty, overdraft, and OTC cash withdrawal fees largely account for the remaining one quarter of total cardholder fee revenue. Overdraft fees are the highest type of cardholder fee, at an average of \$6.90 per occurrence. As of July 21, 2012, the exemption from the Regulation II interchange fee standards does not apply to government prepaid cards if the cardholder may be charged an overdraft fee.²¹ Therefore, overdraft fees are likely less prevalent than they were prior to July 2012.²²

Although figures 2 and 3 illustrate the distribution of cardholder fee revenue on an aggregate level, this distribution is not representative of any particular program. Government offices and issuers negotiate a

¹⁹ For definitions of the various cardholder fees mentioned in this report, see the glossary of terms provided in the survey of issuers at www.federalreserve.gov/paymentsystems/payres_papers.htm.

²⁰ The universe of programs included in the total revenue calculation is the same for each fee type (552 programs). However, the universe of programs included in the average cardholder fee calculation is different for each fee type (routine monthly: 72 programs; purchase transaction: 71 programs; OTC: 431 programs; overdraft: 124 programs; penalty: 401 programs; account servicing: 437 programs; customer service inquiry: 447 programs; and ATM: 522 programs).

²¹ Pursuant to section 920 (a)(7)(B) of the EFTA, the exemption from the interchange fee standards of Regulation II does not apply if, on or after July 21, 2012, the issuer may charge the cardholder an overdraft fee with respect to the card, or an ATM fee for the first withdrawal per calendar month from an ATM that is part of the issuer's network. 12 CFR 235.5(d). Additionally, section 12 CFR 1005.17 of Regulation E places certain restrictions on financial institutions' ability to charge overdraft fees. Currently, Regulation E applies to some, but not all, government prepaid cards covered in this report. The U.S. Treasury requires that issuers of prepaid cards that disburse federal payments provide cardholders with Regulation E protections. 31 CFR 210.5.

²² In fact, the collected data show that overdraft fee revenue as a percent of total cardholder fee revenue decreased from 19 percent in 2011 to 6 percent in 2012.

cardholder fee schedule for each program. Furthermore, the proportion of transactions resulting in the assessment of a cardholder fee depends heavily on the type of program. As a result, there is significant heterogeneity in cardholder fees across programs that use prepaid cards to disburse funds.

Fees Paid by Issuers

Issuers pay fees to third parties when a cardholder withdraws cash from an out-of-network ATM or bank.²³ In 2012, issuers reported paying approxi-

²³ Issuers pay fees to ATM operators for each ATM cash withdrawal to compensate the operator for the costs of deploying and maintaining the ATMs and of providing cash services to the issuers' cardholders. Issuers pay fees to banks for each OTC

mately \$133 million in fees to third parties for ATM withdrawals and approximately \$31 million in fees to third parties for OTC cash withdrawals.²⁴

cash withdrawal to compensate the bank for the costs of manning the teller window and providing cash services to the issuers' cardholders.

In addition to ATM and OTC fees, issuers pay fees to payment card networks (such as switch, license, and connectivity fees).

The Board does not survey issuers of government-administered prepaid cards regarding network fees. Across all debit cards, issuers paid networks approximately 4.5 cents per transaction in 2012. For further information, see "Average Debit Card Interchange Fee by Payment Card Network" at www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm.

²⁴ Issuers reported paying ATM and OTC fees for cash withdrawals with respect to 549 and 537 programs, respectively. On average, issuers paid approximately \$0.57 per ATM cash withdrawal and \$1.37 per OTC cash withdrawal in 2012. Because of limited data, the Board approximated the number of ATM and OTC withdrawals resulting in a fee. Therefore, the calculations of average ATM and OTC fees paid by issuers are estimates.

