

Hybrid Prepaid Cards – A New Opportunity

Date: September 2009

Prepared by:

David Parker

Lindsay Harben

What is a Hybrid Prepaid Card

- As any new industry is typified by new descriptors and jargon prepaid is no different
- There are thus no definitive agreements on what a Hybrid Prepaid card is
- For the purposes of this document though we will consider a Hybrid Prepaid Card to be a prepaid card that also offers the user some form of credit or line of credit they can access through the card
- Hybrid prepaid cards therefore come in two key types:
 - Credit builder
 - True Credit Lines i.e. giving the consumer access to additional funds over and above their own
- A slight variation on the above in the USA has been where the card is made multifunction with multiple wallets. This has been developed for the health care sector where the prepaid is restricted acceptance with sometimes a separate wallet for other expenditure sometimes offering a line of credit
- Some hybrid prepaid cards are not universally welcomed as one commentator put it:

“I believe this is a disaster in the making. The reason for prepaid cards is to prevent or help people live within their budgets and now we are giving a small amount of drugs to an addict and a short term fix until next pay day. History of our credit cards show just how many are maxed out and in default and now we are pushing another drug to the drug addict...does not make sense nor does it seem in the best interest of the people needing SVC.”

Credit Builder

- Credit Builder prepaid products have the aim of helping the customer improve their credit history at credit bureaus.
 - Three different business models exist:
- 1. The Loan Structure**
 - The APS example from the UK clearly shows how this works. The user on purchasing the card in effect takes out a loan e.g. £60 a year. This is then repaid at the rate of £5 per month to APS who at the end of the year report a complete loan repayment.

Case – Study: APS CreditBuilder Prepaid Card

- Feeds a loan repayment history at end of year direct to Experian
- Proven that it improves credit scores of those that complete the contract

Mechanics

- Consumer takes out a card but the fee of £59.40 is an Installment Loan
- Consumer makes 12 monthly payments of £4.95
- 0% APR
- On complete payment of loan reported back to Experian






Success

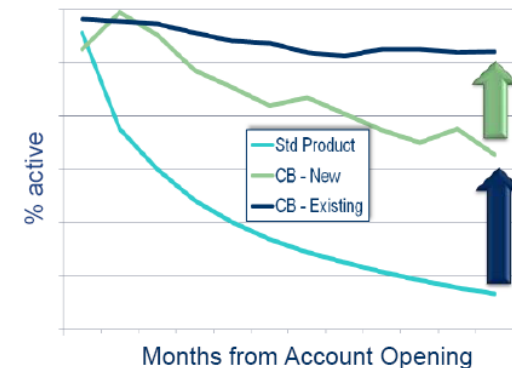
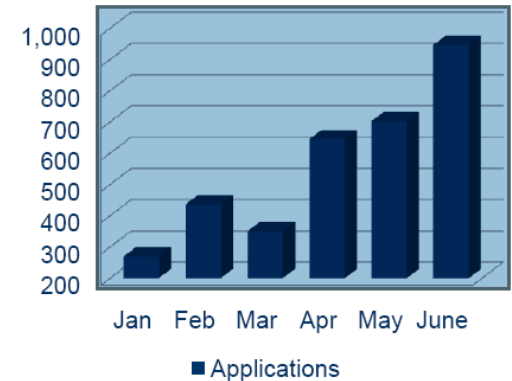
- 1,000 applications in June
- Delivers 3x level of activity rates compared to standard prepaid product
- Average load on Credit Builder is £250 per month compared to average load on standard product of £300 per month
- 8% of total APS portfolio now represented by Credit Builder Product

Load levels

- Average load levels are £250 per month

Delivering a Real Result to Consumer Credit Record

Payment Behavior	Consumer Previous Credit History		
	New	Bad	Good
Good	+40% 	+15% 	+13% 
Bad	-23% 	-7% 	N/A



Source: Presentation at Clarion 09 Prepaid Conference by APS

Credit Builder

2. Lending Back The User's Money (Patent applied for, unclear if global or US only)

- The Ultra VX Card operates differently. It has three accounts;
 - **The Cash Account** is used for cash loads, Money Transfers, ATM transactions, and Bill Payments. This is also where the user must add cash to cover the automatic monthly minimum payment.
 - **The Secured Account** is used to secure the Credit Line. Money is transferred from the Cash Account into the Secured Account to increase their Credit Line. Funds in the Secured Account are not accessible. These funds are used to secure their credit line through Credit-On-Demand.
 - **The Credit Account** is used for all your purchases, and consists of three parts:
 - The **Credit Line** is how much total credit they have.
 - The **Available Credit** is the amount of credit they have to spend.
 - The **Outstanding Credit Balance** is how much of their credit limit they have spent, which is thus how much they owe.
 - **Available to Spend** is the total spending power. This balance is the sum of the Available Credit and the Cash Account balance and it reflects the total amount they can spend. Their purchase transaction will be declined if it exceeds this balance.
- There is then a monthly minimum repayment of 4% of \$10. The Ultra VX card positions itself sometimes as a Credit Card and other times as Prepaid Card
- In effect you can only borrow/spend the amount already in the secured account
- Thus whilst providing credit the user must 'pre fund' that credit first
- Ultra VX then report to the credit bureaus the successful payments of the loans/credit

Credit Builder



3a Reporting History

- In this scenario the card sets itself up as the method of payment of bills and stated they will report you have paid these bills to a credit agency (believed to be run by Netspend)
- The Account Now card Issued by Palm Desert National Bank does this:
- How credit builder works:
 1. Activate AccountNow Bill Pay and add the FREE AccountNow Credit Builder service.
 2. Every time you make a bill payment with AccountNow Bill Pay, we will send your bill payment information to PRBC, a national credit reporting agency.
 3. Build a bill payment history to demonstrate your credit worthiness when applying for housing, credit, insurance, employment, phone, and utility hook-up by doing what you already do today - - paying your rent, electric, cable, insurance, and phone bills on time.
 4. Only Bill Pay transactions will be shared with PRBC. Regular debit transactions using your AccountNow Prepaid Visa or MasterCard will not be reported to PRBC.
- PRBC will compile your bill payment information and create a Bill Payment ScoreSM(BPSSM). PRBC is a credit reporting agency just like Experian, Trans Union, and Equifax, but it is the first to give consumers a choice and an equal opportunity to show that they pay their bills on time.
- They do state though that:
 - Credit Builder is an optional service that is made available to you at no additional cost as part of the AccountNow bill payment service. Credit Builder is only a service that provides your payment history to PRBC, a national credit reporting agency. Credit Builder does not improve or repair your credit record, credit history or credit rating. It also does not provide advice or assistance for the improvement or repair of your credit record, credit history or credit rating. For more information, see Credit Builder Terms and Conditions

Credit Builder

3b Reporting History

- A slightly different model, but in the same vein is run by Eufora.
- They offer three cards, Associate, Preferred and Elite with annual fees of \$29.95, \$59.95 and \$99.95 respectively with various additional benefits
- On the top two levels they also offer a 'Credit Builder' facility
- Eufora simply report the payment history of the user to credit agencies TransUnion and Experian.



How it Works

- Credit Builder requires a 2-year Membership commitment with additional monthly fees. The Credit Builder monthly payments begin on the 2nd day of the month approximately 30 days after the Eufora Prepaid MasterCard® is issued. Eufora will continue to automatically charge the Eufora Prepaid MasterCard on the 2nd day of each month thereafter. The Fees are

Preferred

- \$59.95 Advance Deposit (at time of application).
- \$6.65 per month for 12 months (includes \$19.95 processing fee).
- 100% of your Advance Deposit will be applied towards your 2nd year Membership. You will not owe any additional Membership fees in your 2nd year.

Elite

- \$99.95 Advance Deposit (at time of application).
- \$10.00 per month for 12 months (includes \$19.95 processing fee).
- 100% of your Advance Deposit will be applied towards your 2nd year Membership. You will not owe any additional Membership fees in your 2nd year.

True Credit Lines

- There are currently four types/models offered in the market:

1 Pay Day Loans

- Many of the companies offering 'true additional' lines of credit to users do so on a basis similar to PayDay Loans
- That is the loans are designed for short term small payments
- Consumers normally have to establish a history of regular payments/direct deposits into an/the account or in the UK show a cheque guarantee card
- The consumer can then obtain the loan once the qualifying period has been reached
- A slight variation on this in the USA has been what has been called 'overdraft protection/priviledge'
 - Overdraft Protection (and the name has been evolving) is a "fee per event" model that accesses a specified amount based on a financial institutions rating of the cardholder. The cardholder used to be told what that amount was but this has evolved to a "black box" process to avoid the perception that these fees are an effective interest rate. They are not related to the amount at all.
 - So a card that has been flagged as having an open to buy of \$300 but only \$50 for Available Balance, when faced with a \$75 purchase would access the portion of the open to buy necessary to cover the \$25 purchase price as well as the fee for the transaction (which ranges from \$2 - \$25) necessary to bring the balance to \$0. The "cost of funds" is the same regardless of the amount.
 - With emerging legislation and regulations – any card account with a line of credit in the US – secured or ODP – is at risk of being considered a true credit card. Programs that simply use the prepaid card to fund a loan are in a different position if the card is, but one of a number of fulfillment option provided to the consumer and they elect the card by choice.
 - If the card is the ONLY option, then the card might be considered a credit product with associated fee controls and restrictions – not to mention regulatory overhead. In the USA if you give you a credit line, it is not longer considered a prepaid card, but a credit card. Thus the providers have been through some formula giving a credit line to consumers but not telling them. The credit is thus at the providers discretion, they charge a fee for it and it is a 'privilege' for the user.

True Credit Lines

Examples are:

The Jackson Hewitt® *ipower*® Card

- The iAdvance Line of Credit from MetaBank helps the user secure short term loans for unexpected expenses. By simply establishing a direct deposit they can then obtain the iAdvance. It positions itself as allowing the user to borrow money 24-hours a day, 7-days a week and use a short term loan whilst avoiding overdraft charges and the high fees that often come with payday advances.

Well Fargo Advance

- A Consumer's checking customer's may qualify for a line of credit up to \$500 that can be deposited immediately into your their checking account for a cash advance and access via their debit card.
- They charge a Finance Charge of \$2 for each \$20 advanced, which equates to an Annual Percentage Rate (APR) of 120%.
- The amount advanced, plus the Finance Charge, is deducted automatically from a customers incoming paycheck or other recurring electronic deposit or must be paid in full by a specified due date to avoid a late fee and to continue to use the service.
- To qualify a customer must have a paycheck or any other recurring amounts of \$100 or more are electronically deposited to their checking account.

1st Stop

- In the UK a number of payday loan companies such as 1st Stop offer a prepaid card for loans to be deposited onto and then future loans can be arranged via SMS or telephone
- This is often based on typical UK model of X times the cheque guarantee card



True Credit Lines

FastCash

- The FastCash solution is very similar to the other PayDay loan onto a card solutions except the card is limited to the STAR, Pulse and NYCE debit card accepting retail and ATM networks.
- It is issued by Palm Desert National Bank and processed by eCommLink, Inc.
- Only individuals who have taken out a 500FastCash and have successfully paid off an initial loan are eligible to receive, a FastCash Preferred Card.
- Once a card has been issued then future loans can be paid onto the card in about one hour.
- Cardholders are allowed one free cash withdrawal from a fee free ATM
- A monthly management fee is also charged if funds are left on the card



Pay Day Loans/Credit Build

- It could be argued that the H&R Block card, case study overleaf in effect offers a choice between these two
- Although it does not specifically 'state it passes on' the reporting to the credit bureaus
- It offers a choice of either a small loan based on payroll history i.e. an advance on payroll
- Or it offers a loan based on equal funds held on deposit

Case Study: H&R Block

- H&R Block Inc. enables its customers to have their federal and state income tax refunds downloaded into their Emerald card accounts.
- In addition, cardholders can take advantage of Emerald Advance, which is a line of credit H&R Block offers Emerald prepaid cardholders
- H&R Block charges a 36% annual percentage rate on the loan.
- Last year, H&R Block issued 887,000 Emerald Advance lines of credit
- Cardholders can cut the interest rate on the loan to 9% by opening a deposit account with H&R Block Bank.
- For the emerald advance there are five requirements the user must have:
 1. Completed their taxes with H&R Block
 2. Have a current paystub or w2 (also a picture ID)
 3. Owe no debt to H&R Block
 4. Have an income of \$10,000.00 (or more) in yearly income, plus be expecting a 1000.00 refund.
 5. Establish payroll direct deposit of at least \$500 each month for 2 consecutive months and each month thereafter and receive a maximum line amount of \$300.

Or
Deposit a minimum of \$300 in your savings account for a maximum line equal to the amount deposited.



True Credit Lines

3 Pawn Broker Credit

- A slight variation on the above structure is where Pawn Brokers are paying funds from pawned goods directly onto prepaid cards
- CashPlus has been particularly successful in gaining distribution amongst pawn brokers in the UK



True Credit Line

4 Small Line Credit/Loan to Card

- In the UK the best example of the Loan onto a card is the Provident Money Card.
- Traditional a door step collection structure they now offer an online application, but again with sums collected from the doorstep
- Rumoured to now have over 250k active prepaid cards in the UK market

Small Line Credit

Revel Advance

- Claims to be one of the most affordable small dollar-loan programs to be offered to date on a nationwide scale. Qualified customers establish a small dollar line of credit, have advances loaded directly onto the Revel card
- Balance must be repaid in installments over a four to 10-week period.



Simply Credit

- Developed in partnership with the First Bank of Delaware, Simply Credit is an open-end line of credit providing consumers with immediate access to cash 24 hours a day, 7 days a week.
- Funds are immediately transferred to the consumer's prepaid card, providing them the convenience to quickly pay bills or access cash via the ATM.



A Word of Warning for EU Prepaid Businesses



A different approach

- If the organisation is running a prepaid card out of an ELMI (electronic money institution') then under the Electronic Money Directive the organisation **MUST NOT** carry on any other business than the issuing of e-money and necessary connected services to be able to do it
- This would mean that if the organisation wish to run any kind of Hybrid Product it must be through a separate legal entity (which could be a subsidiary or group company).
- If the product is the granting of credit (like Credit Builder etc.) then a separate consumer credit licence would be required in the UK and in other EU countries it may have to be run through an Authorised Credit Institution (Bank).

The logo for Polymath Consulting features the company name in a white, sans-serif font. The word "polymath" is in a larger font size than "consulting". The text is centered within a network of white lines that radiate from a central point to eight small white circles, creating a starburst or network effect.

polymath
consulting

David Parker

davidparker@polymathconsulting.com

07712 079 307

www.polymathconsulting.com