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MERCATOR ADVISORY GROUP

Opportunities in Prepaid: Advice for the Financial Institution

A Mercator Advisory Group Whitepaper Sponsored by Fiserv

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About Fiserv

Fiserv, Inc. (NASDAQ: FISV) is a leading global technology provider serving the financial services industry, driving innovation in payments, processing services, risk and compliance, customer and channel management, and business insights and optimization.

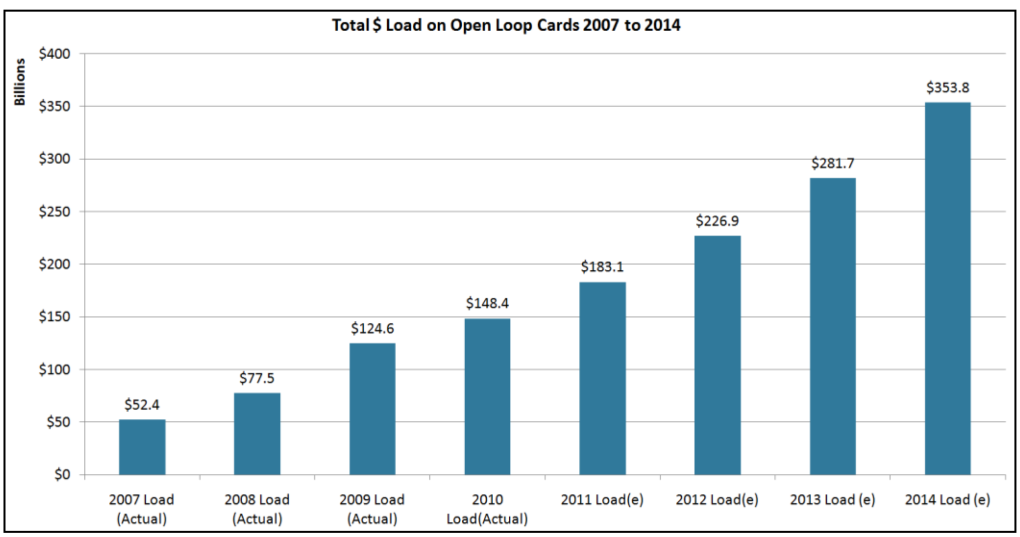
Card Services from Fiserv provides comprehensive debit, credit, prepaid, and ATM processing services to more than 3,200 financial institutions across the United States. Fiserv owns the ACCEL/Exchange Network, operates 18,500 ATMs, and processes approximately 11 billion transactions annually, making it one of the largest financial transaction processors in the nation. For more information, visit www.fiserv.com.

Introduction

Several large banks have launched prepaid products in 2012[1] and, given current efforts among other banks that Mercator Advisory Group is aware of, this pace will continue. The increased deployment of prepaid solutions is driven in part by a regulatory exemption that financial institutions (FIs) can utilize to capture the highest possible amount of interchange, partially offsetting the negative impact of the Durbin Amendment to the Wall Street Reform and Consumer Protection Act. Financial institutions' adoption of prepaid is also driven by their realization that if they can't provide a prepaid solution to a corporate client, competitors often can. Lack of prepaid products provides competitors a beachhead into an FI's corporate accounts. Add the fact that the open-loop prepaid market (payment devices with funds preloaded in an associated account to be spent subsequently) has a compound annual growth rate of 34.5% (*Figure 1*), and it becomes clear that prepaid is an important new product area that improves profitability, blocks competitive inroads among an FI's existing clients, and drives card unit and dollar volume growth.

Three primary market constituents purchase prepaid products—consumers, businesses, and government—and each utilizes a different variation of prepaid product. The report reviews the various product types for each of these markets. Consumers use prepaid cards as a replacement for a traditional checking account or as a budgeting tool to complement an existing checking account. Prepaid products purchased directly by consumers include open-loop gift cards, prepaid financial services cards, teen/student cards, and travel, health, and turn-down products (for consumers who have been refused or "turned down for" a demand deposit account).

Figure 1: Funds Deposited on All Open-Loop Prepaid Products in the U.S., 2007–2014



Source: Mercator Advisory Group 2010 Prepaid Benchmark Forecast

[1] Comerica in July, PNC in July 2012, Chase in May, Wells Fargo in March, Regions in March.

Prepaid solutions used by business and government agencies eliminate the cost of disbursing funds by check. The products include payroll cards, incentive and reward cards, time and expense solutions, campus products, unemployment solutions, and health savings accounts. Each of these solutions meets a different need and is implemented and sold in a different fashion, and each is reviewed later in this report.

Prepaid products are offered by the majority of top tier financial institutions today, including American Express, Bank of America, BB&T, Capital One, Chase, Citi, Regions, Suntrust, U.S. Bank, and Wells Fargo.[2] The matrix of prepaid product availability shown in *Figure 2* was compiled by Mercator Advisory Group by reviewing leading financial services providers' websites. The matrix clearly demonstrates how pervasive prepaid products have become in the larger financial institutions. However, deployment is not limited to large financial institutions; many institutions either have a prepaid product today or are establishing business plans to launch a prepaid product or to launch additional prepaid products.

Figure 2: Top Financial Institutions Have Invested in a Broad Range of Prepaid Products

	Amex	BoA	BB&T	Cap 1	Chase	Citi	Regions	Suntrust	U.S. Bank	Wells Fargo
Gift	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
GPR/PFS	✓	O	✓	✓	✓	O	✓	O	✓	✓
Payroll	O	✓	✓	O	✓	✓	✓	✓	✓	✓
Incentives	✓	O	✓	✓	O	✓	O	✓	✓	✓
Government	O	✓	✓	O	✓	✓	O	✓	✓	✓
Campus/Teen	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

Source: Institutions' public websites

This report identifies the two different categories of prepaid products that financial institutions are considering. One category is products that address consumer demand (such as gift cards, travel cards, prepaid financial services, budgeting cards, and teen cards). The other is products deployed to business and government agencies to lower the cost of disbursements (such as payroll cards, incentive/rewards cards, and unemployment cards). For each prepaid product category that applies to financial institutions, Mercator Advisory Group identifies the key drivers of adoption and explains the steps a financial institution should take to create a prepaid business plan that will properly address the institution's unique market position and internal assets.

[2] Information on products is readily available on each financial institution's website.

Defining Prepaid Terms

From a regulatory perspective, prepaid products are defined as "an account structure with the cards linked to a subaccount drawing from a pooled account rather than an account held for the benefit of an individual." This definition is one attribute that must be in place to qualify for an exemption from the interchange restrictions created under the Durbin Amendment.

This carve-out under Durbin applies to general purpose reloadable (GPR) cards. However, several unique products have evolved out of the GPR family, each for a different purpose, or use case. Because of the unique nature of each use case, the term GPR has become insufficient to identify specific market opportunities that financial institutions are targeting. Therefore, instead of using the generic term GPR, the analysis in this paper uses terms that align with the various use cases or market segments such as budget card, teen card, or prepaid financial services card. For each use case, different regulations and risk profiles must be managed, and each product requires a range of specific card and account capabilities if it is to succeed in the market.

For example, a teen card usually requires two different views into both the account management functions and the transactional records—one view for the parent account holder and the other for the teen—as well as some level of parental controls over the teen's spending. More complex risk management may be necessary if the card is enabled to accept cash deposits at retail locations for the teenager. Such extended capabilities are not required for a budgeting card since such a card is likely to be associated with just one individual and may be closely linked to a demand deposit account (DDA).

Review of Consumer-Acquired Prepaid Products

Gift Card

In 2010, $12.6 billion of consumer funds were loaded onto gift cards in the United States. In 2011, the load value grew by 19%, which Mercator Advisory Group expects will remain the growth rate through 2015. Consumer research that Mercator has conducted annually since 2009 continues to indicate that this gift card market is far from saturated and that consumers prefer the freedom of choice embodied in open-loop gift card solutions. In addition, Mercator expects that the elimination of fees required under the Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009 will continue to increase consumer adoption as the increased safety of the funds becomes broadly recognized. However, although financial institutions often consider prepaid gift cards important to address account holders' needs, few FIs will be able to create a profitable gift card portfolio. That is because the margins on gift cards were already razor thin, and with the dual-routing regulations implemented by the Federal Reserve Board pursuant to the Durbin Amendment, existing gift card programs will become even less profitable. So while it is likely most financial institutions will continue to offer gift cards to customers, their gift card programs will likely be an expense. This loss should not be construed as an indictment of all prepaid products, however, since other prepaid products can deliver significant income and cost savings when properly implemented. With sufficient volume, it is also possible to deliver a gift card program that aligns with other prepaid programs to drive up total volume. The increased volume offsets the loss on the gift card program while increasing profitability on the other prepaid programs the institution has implemented, assuming they all leverage the same resources.

Travel Card

Travel card dollar load volumes by consumers are on the rise. Load volume on these cards rose 9% in 2011 due to a combination of increased travel and increased need for EMV cards in Canada and Europe. More financial institutions have begun to deploy travel cards embedded with an EMV chip to support account holders traveling to countries where transactions require EMV chip cards or to countries with such high risk that a transaction on an existing magnetic stripe debit card is not accepted if it originates from those countries. Travel card products in the market today are poorly differentiated from budget cards or other reloadable prepaid cards in that current cards provide little value specific to traveling. Initially, travel cards included emergency services and other benefits, but as suppliers such as American Express left the market five years ago, these services were no longer widely offered. Financial institutions can follow one of two paths. They can deploy a travel card designed for that single purpose or link the travel capability to a budgeting card or teen card. In the latter scenario, the financial institution provides an upgrade to an existing prepaid budgeting card such that the price of acquisition covers the cost for the EMV-enabled card and opens the account to purchases made internationally. By enabling the upgrade of an existing prepaid account, transaction volumes are increased on the existing prepaid program, which lowers cost of operations, hence increasing program profitability.

Budgeting Card

Mercator Advisory Group's CustomerMonitor Survey Series consumer research indicated in 2011 that 35% of consumers use prepaid cards to budget their spending. Of these, 16% used the card to send money to friends and family, 11% used a card to help friends or family members to budget, and 8% used a prepaid card as their own budgeting tool. A financial institution should begin by evaluating the spending patterns of its existing account holders. The FI should study ACH records to determine the volume of funds currently leaving the institution and going to competitive prepaid products, and perhaps perform customer research to determine the account holders' interest in a prepaid budgeting card. It is relatively easy to calculate the potential value of a prepaid product that is adopted by 35% of the FI' existing accounts—or even half that penetration rate.

Teen Card

A typical use case for prepaid reloadable products provides parents with a controlled funding mechanism for their children. The market offers a range of products, some designed to train the teen regarding responsible spending, some designed to track chores and upon their completion reward the child with allowance disbursements, and others that are basic general purpose reloadable products marketed to teens (a marketing plan that is high risk unless it requires parental involvement). The first prepaid teen card was designed so that parents could limit, monitor, and control teen spending. Though still available, these products have very limited adoption. Adoption is low because few parents want to take the time needed to monitor and control teen spending, and very few teens want a card that requires a discussion with their parents every time they use it. More popular are prepaid products that simplify and add control to the existing behavior patterns of parents and teens. The teen convinces the parent to fund a particular purchase. The prepaid product makes it extremely easy for the parent to fund the purchase from the household's existing account and then provides the parent and the teen transaction-level details that indicate the teen purchased a product from the specified store. For a financial institution, the relatively small additional investment in the prepaid platform necessary to enable such a product keeps costs low and adds volume to the existing prepaid implementation.

Prepaid Financial Services Card

Many financial institutions looking to improve profitability of low-balance account holders and to target families and individuals with low and moderate income (LMI) have implemented prepaid solutions that replace a traditional checking account. These prepaid financial services products are made available in a range of solutions described below.

Turn-Down Product

A turn-down product is a prepaid card that can be provided to account applicants who fail to meet the minimum requirements for a checking account, most typically because the individual has a negative history file with Chexsytem or a similar database. By offering prepaid financial services (PFS) solutions, financial institutions can be assured that every prospect who walks into a branch can be provided a product. While the turn-down product can assure that prospects have the opportunity to become customers, most financial institutions have such a low volume of turn-downs that the solution is typically profitable only if the prepaid solution is just one aspect of the turn-down product. For example, PFS solution that acts as a prepaid turn-down product can also be positioned as a check cashing card.

Check Cashing Card

Among the services financial institutions have deployed to cater to low and moderate income consumers are remittance services, money orders, and check cashing. A PFS product can reduce the risk associated with check cashing while also increasing profitability. The first benefit of the PFS product is that it provides the opportunity to test the individual check casher's identity just once and then to establish a history of the types of checks the individual has cashed, which greatly improves risk management. In addition, depending on the risk associated with a specific check presented, funds can either be made available immediately or delayed until after the check clears. When combined with remittance services and money orders, this solution can generate significant new revenue from an often overlooked demographic.

The Prepaid Financial Services Account

Most of the recent announcements from large financial institutions introducing prepaid products have related to prepaid financial services. PFS products are made broadly available through the retail branch network and can be loaded from existing accounts, at teller locations, and at the ATM. These prepaid cards are typically not marketed to a specific use case, as are turn-down and check cashing cards, but instead are offered to consumers to be used any way they wish. Financial institutions primarily offer these cards to be used as a financial account, similar to a bank account; consumers often use these cards as budgeting, teen, and hobby cards.

Review of Corporate and Government Prepaid Products

Prepaid products that address the needs of corporate and government clients are substantially different from those sold to consumers. Corporate and government prepaid card programs use different business models and distribution channels, and they require product modifications to manage different risks and comply with different regulatory requirements.

Campus Card

College and university campuses have multiple solutions that utilize the campus card currently issued to students. The primary function of the card is security, providing personal ID as well as secured access to dorms and other parts of the campus. Because of the critical nature of this security function, it is imperative that these cards be reissued on campus within minutes if lost or stolen. Campus cards have begun to take on new functions as well, and are often used to grant access to resources that require controlled usage, such as campus food courts (where three meals a day are included on the meal program, not five), computer access, or laundry machines. Campus cards are also increasingly used to manage access to resources that require compensation, such as color printers or vending machines. In these situations, the campus card is linked to a student financial account funded by the student and the student's parents to meet spending needs for tuition, vending machines, student health, local transit, and other expenses.

Increasingly, colleges and universities are looking for a more efficient mechanism for disbursing student loans. A financial institution currently supporting such a school can help lower the school's costs by providing a prepaid product that acts as both a security card and a financial instrument. This is typically accomplished by issuing the students a card that has the traditional security magnetic strip on one edge and the open-loop card magnetic strip on the opposite edge. There are significant benefits to both the FI and the school that implements such a prepaid product. Unlike a traditional checking account, the campus card can be made available to the student by the school directly and with extremely high confidence that no student will be turned down, even if the student has mismanaged a bank account in the past. The prepaid solution can also become an all-electronic disbursement mechanism for the school's administration. When all students are issued a prepaid account, then all student loans and compensation for work on campus can be issued electronically, eliminating the need for paper checks.

Some campus cards can be used by students at local merchants that have signed a contract with the college or university agreeing to pay some percentage of each sale back to the school. To accomplish this, the school deploys special point-of-sale (POS) devices to each participating merchant. Implementing a campus card on the appropriate prepaid platform eliminates the need to deploy a POS device to each merchant. Instead, the prepaid platform restricts acceptance off campus to only those merchants that have signed a contract with the school. The concept can be extended by signing up other merchants that agree to offer student discounts and by offering prepaid or decoupled debit cards not only to students but also to alumni and friends of the college or university.

Payroll Card

Of all the prepaid market segments, payroll is by far the most complex to enter. The complexity derives in part from the payroll business itself, a complex market that is highly regulated at the state level. Because of this complexity, issuing payroll card products often requires the financial institution to implement dedicated teams for sales, marketing, and support. This staff must address multiple training and support needs, including the employer's Human Resources staff, all levels of the employer's management team, and the processes associated with card stocking and distribution strategies, not to mention appropriate literature to train and support the employees.

Regulatory issues also add to the payroll product's complexity. Most states have passed regulations that govern the deployment and operation of payroll cards, but the regulations are often vague, difficult to implement, or both. For example, some states require the ability to pay to the penny. Arranging for pay-to-the-penny that unambiguously meets state regulations can be difficult. Moreover, the "Know Your Customer" (KYC) environment for payroll implementations is complicated because the employer will be providing some of the required employee information. The financial institution's ability to offset the costs associated with the extra training and feature sets required for payroll card programs is somewhat limited because of regulations that limit employee fees.

Employee and Partner Incentive Cards

A reloadable employee and partner incentive card is arguably the least complex prepaid product that can be deployed by a financial institution. There are no regulations specific to an incentive product, although large overarching regulations such as the Durbin Amendment, Office of Foreign Assets Control (OFAC) requirements, and others will still require attention by the issuer. Deploying a prepaid incentive solution to a business requires the business be vetted relative to payment risk, which is also true for payroll cards. This is similar to the process financial institutions perform when underwriting a loan or when acquiring card transactions. Once the vetting process is completed, deployment of the incentive card is typically relatively simple. Employee incentive cards may or may not have ATM cash access, depending on the goals of the employer. The card may or may not have fees associated with different cardholder transactions, also depending on the operational needs of the employer. For incentive cards, unlike payroll cards, the primary cardholder support is for balance information through the Web and interactive voice response (IVR) at a call center. Of course, the incentive prepaid product is a GPR option to issue only for financial institutions that sell to corporations.

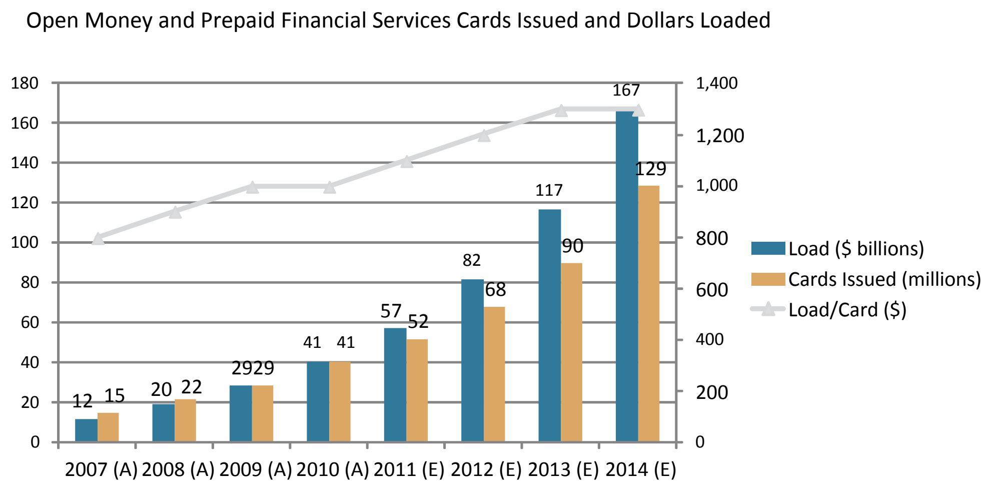
Government Disbursements

Federal, state, and local governments use prepaid cards to disburse funds to several target audiences, including those receiving social security, nutritional assistance, emergency funds, unemployment compensation, wages, and government incentives. While some of these program participants may not be good sales targets for most financial institutions (Social Security, Supplemental Nutritional Assistance Program (SNAP) [formerly food stamps], armed forces payroll, etc.), there is a trend that suggests opportunity does still exist to displace existing bank relationships. State and local government agencies have shown interest recently in aligning themselves with local financial institutions since the local institution will keep the funds in state. The prepaid programs that may come into play include state unemployment programs, state and local payroll programs, incentive programs including gun buy-backs and energy discounts, and other programs involving cash disbursements.

Understanding Prepaid Market Dynamics

Mercator Advisory Group estimates that the total dollar volume loaded on open money and prepaid financial services cards will grow at a 42% compound annual growth rate through 2014 and will achieve a load value of approximately $167 billion by 2014 (*Figure 3*).

Figure 3: Load Value Placed on Prepaid Financial Services Products, 2007–2014E



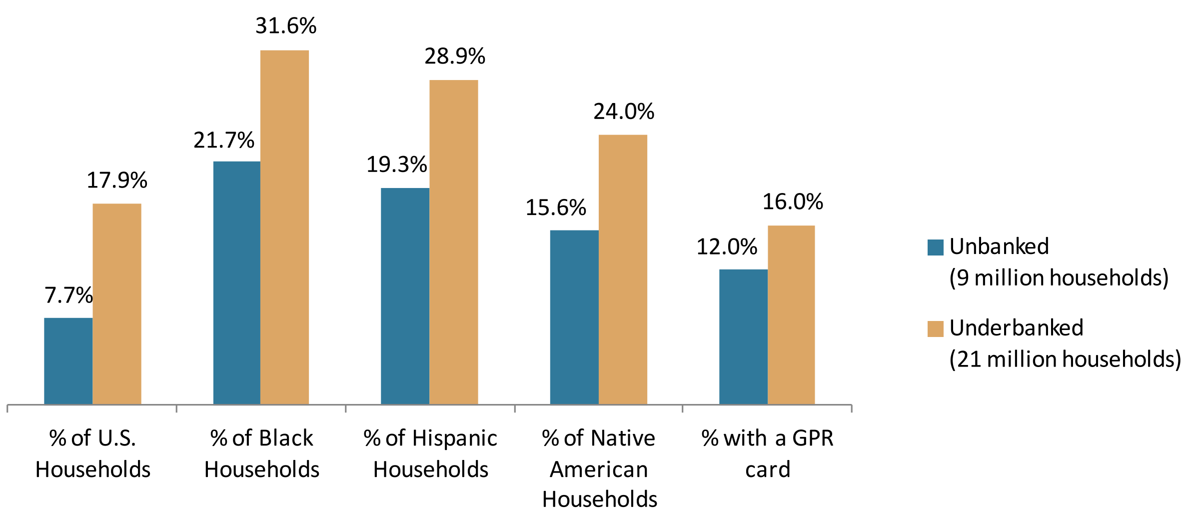
Source: Mercator Advisory Group, 2012

Multiple prepaid products are driving the tremendous growth illustrated, each addressing a different aspect of the consumer market. We begin discussion of market dynamics by reviewing the low and moderate income (LMI) market, also called the unbanked and underserved market, since that segment is often the primary topic of conversation. However, after that review we will look at target markets that put financial institutions' existing accounts in the crosshairs of competitors.

The LMI Market Is Growing

More than 25% of U.S. households are unbanked or underbanked. *Figure 4* illustrates the demographic distribution of this market. The U.S. unbanked population comprises 17 million adults across 9 million households, while the underbanked population has 43 million adults and 21 million households according to the most recent Federal Deposit Insurance Corporation study, conducted in late 2009. In contrast to the unbanked, who have no bank account, the underbanked have bank accounts but utilize alternative financial services as an adjunct to the financial products offered by banks.

Figure 4: Unbanked and Underserved, by the Numbers



Source: FDIC Survey of Unbanked and Underbanked Households, December 2009

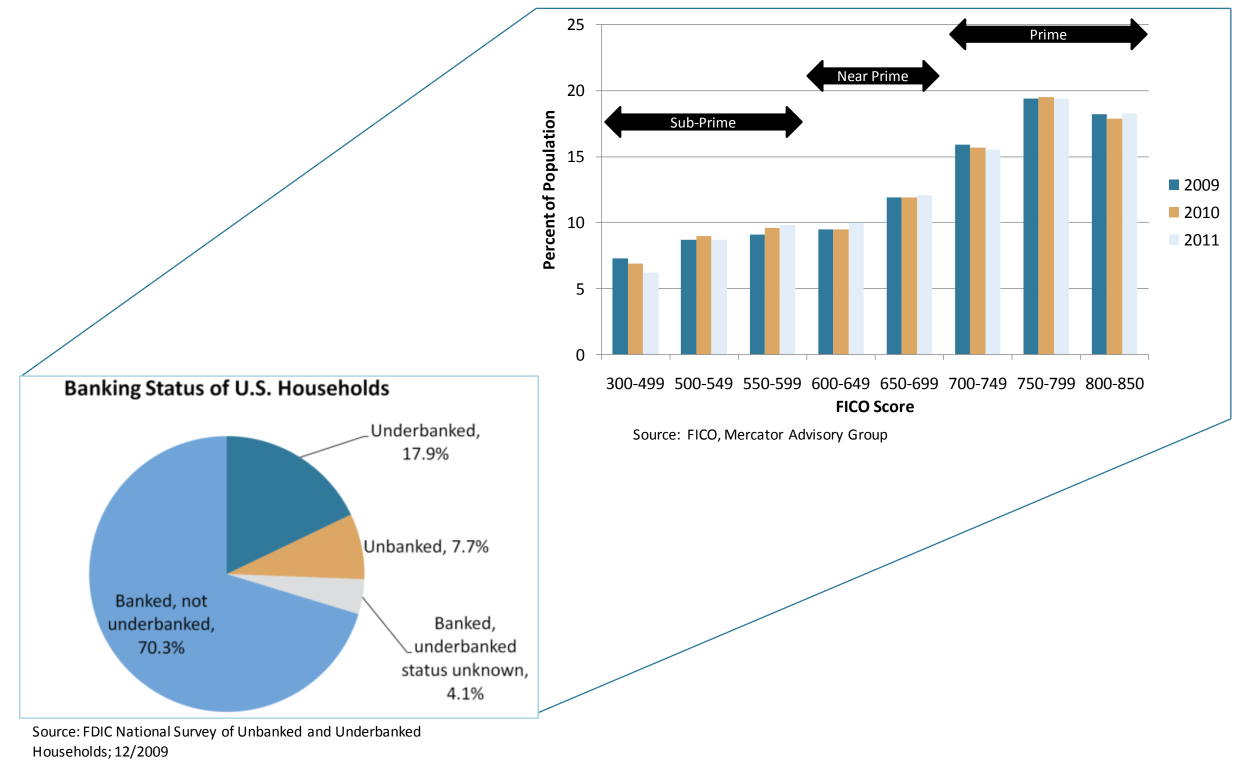
Since the FDIC 2009 study, the economic slowdown has made the unbanked and underbanked a rapidly growing demographic as average daily balances and average FICO scores have dropped.

Average Daily Balances and Average FICO Scores Are Dropping

Financial institutions have been evaluating the unbanked and underserved market associated with the FDIC's Community Reinvestment Act for some time, as shown in *Figure 5*, where the designation "Low and Moderate Income" is used to describe a similar demographic based on income rather than banking status.

The LMI market has continued to grow during the recent difficult economic climate, which appears to persist. The upper right area of Figure 5 shows that a small, gradual slide in FICO scores has occurred, especially in the FICO score range 550 to 599. The drop in credit scores indicates that an increasingly large number of banked customers are credit impaired. Consequently, a larger percentage of consumers have a lower average daily balance than in the past. This trend has two ramifications: (1) more account holders are having difficulty maintaining an average daily balance sufficient to manage a traditional checking account, and (2) banks have a greater number of accounts that are not profitable or marginally profitable. The shift from prime to near prime and subprime is also indicative of a shrinking market for traditional banking services that rely on credit.

Figure 5: As Prime and Near Prime Decrease, the LMI Market Increases



Sources: FDIC, Mercator Advisory Group, 2012

The erosion in average daily balances suggests that retail financial institutions should consider introducing a range of banking products designed to satisfy the needs of the expanding LMI market. To do this will require recognizing the needs of the LMI community and providing products and services that address these needs, which means improving liquidity, convenience, and price.

Products Targeting the LMI Community

The vast majority of prepaid products in the market today identify the needs of the LMI as the target market. While nonbanks were the first to enter this market, it appears clear that financial institutions, both large and small, also intend to participate. Among these institutions are BB&T, Chase, U.S. Bank, and most recently Citizens Bank, but the most comprehensive and highly advertised program is the Regions Now Banking solution, which has targeted the LMI market segment with an advertising campaign that began in January 2012.

The Now Banking program provides persons of low and moderate income a broad range of products and services that includes remittance, money orders, check cashing and of course, a prepaid card. John Owen, Regions' senior executive vice president and head of consumer services has stated, "We believe it [Now Banking] will be popular among our current customers, and we hope the people who currently utilize check cashing places and Walmart will come to us too."[3]

Now Banking will cash a wide range of checks for anybody—both existing customers and noncustomers—including third-party checks, personal checks, and nongovernment checks. The checks are instantly converted into good money when the check is accepted. Other notable features of the program are Western Union remittance services for overseas money transfers and access to the Regions reloadable prepaid card. A Regions spokesperson claims that its fees are generally one-third to one-half the amount of the fees charged by typical nonbank providers. The Now Banking solution was created when Regions Bank discovered that 30% of its existing customers indicated they had used one or more nonbank financial services within the previous 90 days and nearly half indicated they would use these services if Regions provided them. After a brief pilot phase (conducted in July 2011) proved more successful than expected, Regions increased spending on TV advertising and rushed deployment to all 1,700 branch locations, completing the deployment in March 2012.[4]

How Bank Customers Utilize Prepaid

The LMI market is not the only consumer opportunity in prepaid. As mentioned earlier, many prepaid products are available for banked individuals and families, including budgeting cards, teen cards, and hobby cards. While these use cases are sometimes addressed with a custom product, more often than not the consumer who wants to use a prepaid card for one of these purposes simply acquires a prepaid financial services product. For example, in an interview with Paybefore magazine, U.S. Bank indicated that roughly half of the cardholders using a U.S. Bank prepaid card already have a relationship with the bank.[5] Such customers almost certainly use the prepaid cards not as an alternative to a checking account but as a mechanism for controlling their spending. The alternative uses were possible because barriers to entry were low since the prepaid card can be reloaded at the branch for free. Chase has taken a similar approach with the Chase Liquid prepaid card, which waives the $4.95 monthly fee as long as the card is linked to an existing Chase checking account.

The ability to connect the prepaid card to an existing bank account is a major advantage that financial institutions have over nonbanks in this market. Consumers who walk into a financial institution or access a financial institution's website are already thinking about finances and are prepared to move money—which makes the visit to the branch or website the perfect time to acquire and fund a reloadable prepaid card.

[3] "Regions rolling out non-traditional financial services with Regions Now Banking," Roy L. Williams, The Birmingham News, http://blog.al.com/businessnews/2011/11/regions_rolling_out_non-tradit.html.

[4] Ibid.

[5] Paybefore, "Parade of GPR Cards by Big Banks Continues with Chase," May 2012.

A Mature Prepaid Delivery Service Model

The implementations of prepaid products have evolved significantly over the last several years as processors and program managers have gained experience integrating the various processes and services necessary to support the different prepaid product market segments. For example, several prepaid products, including incentives, payroll, and teen products, require one or more customized landing pages. Each landing page must be designed to present information to specific users, such as the cardholder, the employer's line management, or the employer's Human Resources Department. To accommodate this requirement, implementers have developed application programming interfaces (APIs) that facilitate secure integration of data collected from the prepaid card into existing Web pages. New Web platforms enable rapid development of websites that can easily access the prepaid card data in a secure environment. Implementers that have expertise in incentives have developed specialized capabilities, from funding processes that minimize the funding required so that the client can send only those funds required by currently active cards on a daily basis to support for the "creatives" that accompany card fulfillment, such as the card carrier, Web page, and IVR.

This integration of the various components needed to deploy a prepaid solution helps lower the costs associated with starting a program and reduces the time required to bring the product to market. Of course, not all implementers have experience in all the segments a financial institution may be interested in, and even if they do, that experience doesn't guarantee they have implemented the best practices associated with that segment. Therefore, properly vetting suppliers regarding their depth of knowledge of each product type remains an important aspect of deploying a prepaid program.

Aligning Prepaid Products with Your Institution's Business

The first step to creating a business plan for prepaid is to review your own institution's position in the market. Depending on your business model, you may decide to evaluate any or all of the following prepaid product solutions:

1. To capture new consumers: LMI, turn-down.
2. To better serve your existing consumers: budget, teen, campus, incentive, travel
3. To target commercial customers: payroll, incentive cards, government disbursement

Properly implemented, the prepaid products selected align with the market opportunities represented by your institution's current retail and commercial account base. The program will block competitors attempting to make inroads into your existing account base, will establish new accounts from within your geographic footprint, and will align with the capabilities of the prepaid service providers you choose as partners to bring these products to market.

It is critical to recognize that each prepaid product identified above requires special features to be successful. A turn-down product must be integrated into the branch processes, while incentive cards need to be woven into the processes of the financial institution's corporate clients. A turn-down product needs only a single landing page for account status, while a teen card needs a landing page for the parents and another for the teen. Because of these product variations, it is important to determine which prepaid products the institution will implement and the special features needed to support each. This evaluation assures costs are well understood and guides vendor selection, since the goal is to minimize the number of suppliers needed to meet all product-specific needs. The more volume that can be concentrated through a single supplier, the easier it will be to reach breakeven because costs drop with increased transaction flow.

Evaluating prepaid is not a one-size-fits-all proposition because no two institutions are exactly alike. Some institutions have no corporate clients, others have no retail clients, while most fall somewhere in between. Retail institutions may already have a post-Durbin Amendment strategy to move up-market, while others may have decided to introduce new products to better serve the many customers experiencing income contraction. Given this wide variation in market positions, no one-size-fits-all business plan is feasible, and each institution must decide for itself where it will start. A solid business plan for evaluating entry into the prepaid market will follow the steps listed in *Figure 6* for each prepaid product being considered.

The first step related to building a business plan is for the financial institution to estimate the number of accounts, and the number of cards per account, that can be won over the next three to five years. This is accomplished by first considering opportunities within the FI's existing accounts and then estimating the number of new customers that could potentially be won if the FI had the prepaid product under consideration.

Figure 6: Six Critical Evaluation Steps for Developing a Business Plan for a Prepaid Product

Criteria for Evaluation	Description
1. **Existing opportunities**	Identify the number of potential clients in the existing installed base and the volume potential the clients represent.
2. **New opportunities**	Based on the institutional geographical footprint, identify new opportunities and identify potential volume and uptake using conservative assumptions.
3. **Income estimates**	Based on the volumes projected above, build a model for load, spend, and support transactions; then estimate income from interchange, fees, and float.
4. **External expenses**	Apply the transaction model described above to a conservative estimate of the transactional costs that will be charged by suppliers if the opportunity is pursued.
5. **Internal expenses**	Identify costs associated with internal resources that will be utilized for the prepaid product, such as KYC, IVR, or other functions. Apply these costs to the model.
6. **Integration efforts**	Where integration to ATM, teller terminals, or internal branch operations is required, identify the one-time cost associated with the effort and add to the cost model.

Source: Mercator Advisory Group, 2012

Using a prepaid incentives product as an example, a financial institution would review all its current corporate accounts to identify those likely to have profitable incentive programs. Companies that manufacture packaged goods, large retailers, and manufacturers of durable goods are just a few of the business categories known to be large users of incentive products. Knowing what types of companies are likely to use incentive products enables the program manager to create a ranked list of existing clients. Identify existing corporate accounts that are the primary users of prepaid incentive cards, ranking them by funds on deposit and sorting the list by North American Industry Classification System (NAICS) code.

It is highly likely that current customers have asked the FI's sales representatives for incentive cards. To collect this information, poll the entire sales team, but have the sales representatives associated with the top companies on the target list directly engage these clients to determine not only whether the opportunity exists but also the potential volume. These actions will create a list of the current opportunities and potential card volume from existing accounts. Of course, the market is larger than just an FI's existing accounts!

To document the opportunity outside the FI's account base, create a list of relevant companies that operate in the institution's geographic footprint. This is accomplished by creating a list of the companies within the footprint, ranked by revenue and by NAICS codes most relevant to the use of incentive cards.

Next, plug the data points collected from these two research efforts—existing accounts and new opportunities—into a pro forma spreadsheet to identify the potential profit/loss for this product. Replicate this approach for each segment the financial institution is interested in evaluating. If the data is compelling and the FI decides to target a prepaid segment with a product, the institution now has a target list for sales within existing accounts as well as a ranked target list for new business opportunities.

Of course, any decision to proceed will depend on the results of the pro forma. The income associated with a prepaid product is relatively well defined, consisting of interchange, fees, and float, but there are far more line items associated with cost, and each is variable. Costs associated with prepaid processing vary among suppliers but, in Mercator Advisory Group's experience, these variances are relatively small compared to the wide variances related to the way financial institutions charge for using their own internal services. For example, the cost associated with achieving compliance with Bank Secrecy Act requirements on a new prepaid card account varies greatly among financial institutions, as do costs associated with IVR support, live agents, and website development. Perhaps more important are the costs associated with integrating a prepaid solution to the financial institution's ATM fleet and teller terminals, if it is decided this level of integration is required.

Performing the evaluation of a prepaid product requires knowledge specific to the segment under consideration. Evaluating multiple segments requires an understanding of the components of each segment implementation that can be shared with the other segments under review versus which components will be unique. Where appropriate, this evaluation effort can be assisted with trusted partners that have prepaid expertise. Regardless where the expertise comes from, developing a full business plan that properly assesses the size of each prepaid opportunity and the profitability of each is critical for a successful implementation.

If You Don't Provide Prepaid, Customers Will Go Elsewhere

How many of your customers would like to have a prepaid card? How many already have one? Mercator Advisory Group urges financial institutions to measure the inroads that competitors have already made into their customer accounts: Research the institution's ACH records to measure the funds that are associated with ACH Debits originating from existing prepaid suppliers—the results will likely prove surprising. And before an institution decides customers have no motivation to adopt prepaid financial tools, it should recognize that numerous bank and non-bank competitors are targeting the institution's account holders. Offering prepaid programs will help banks prevent deposit and transaction runoff and provide an additional way to engage customers.

About Mercator Advisory Group

Mercator Advisory Group is the leading, independent research and advisory services firm exclusively focused on the payments and banking industries. We deliver pragmatic and timely research and advice designed to help our clients uncover the most lucrative opportunities to maximize revenue growth and contain costs. Our clients range from the world's largest payment issuers, acquirers, processors, merchants and associations to leading technology providers and investors. Mercator Advisory Group is also the publisher of the online payments and banking news and information portal PaymentsJournal.com.

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