Smart Card Alliance

A Guide to Prepaid Cards for Transit Agencies

A Smart Card Alliance Transportation Council White Paper

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About the Smart Card Alliance

The Smart Card Alliance is a not-for-profit, multi-industry association working to stimulate the understanding, adoption, use and widespread application of smart card technology. Through specific projects such as education programs, market research, advocacy, industry relations and open forums, the Alliance keeps its members connected to industry leaders and innovative thought. The Alliance is the single industry voice for smart cards, leading industry discussion on the impact and value of smart cards in the U.S. and Latin America. For more information please visit http://www.smartcardalliance.org.

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1.1   Industry Basics

For the past several years, transit agencies have been moving away from cash-based fare collection systems to contactless smart card-based systems. In most cases, the cards issued have been closed loop payment cards; that is, cards that can only be used to pay transit fares. Recently, in an effort to both reduce the costs associated with administering these systems and make the systems more convenient for customers, transit agencies are considering accepting contactless bank cards at points of entry, eliminating the need for customers to buy a transit-specific card.

The purpose of this white paper is to provide an overview of the prepaid card industry and the products available, including network-branded prepaid cards. It is directed to readers who work for or support transit agencies. The paper provides guidance on what transit agencies should look for when evaluating the feasibility and benefits of using prepaid cards as one element of an open loop fare collection system. The paper also provides useful information to other members of the prepaid card industry who have an interest in collaborating with the mass transit industry to expand the use of prepaid cards.

As banks continue the process of converting credit and debit cards to include contactless features, a large number of transit riders will be able to use these new cards on transit systems. However, transit agencies have a long-standing mandate to serve all constituencies in their service areas. Any movement to adopt financial industry products, such as bank cards, would therefore require that all riders be able to obtain such a card conveniently. Because some segments of a transit agency's ridership may not qualify for a credit or debit card or may be uninterested in establishing a relationship with a bank, transit agencies should consider promoting the use of prepaid cards that can operate like a bank card but be available to anyone.

Non-reloadable "instant" prepaid cards provide this service. Because there is no requirement for consumers to apply for these cards, they cannot be declined. Non-reloadable "instant" prepaid cards are "cards for cash" in the simplest form. These can be limited to use at a single merchant, but they can also carry payment network branding enabling customers to use them at a wide variety of merchants, up to the amount loaded on the card at the time of purchase.[1]

Another option is to use more sophisticated reloadable prepaid cards. These cards are issued by financial institutions and carry a payment network brand, such as American Express, Discover®, MasterCard® or Visa®. Such cards are easier to obtain than a credit or debit card, since there are no credit approval requirements. The customer only needs to provide simple identification information to meet regulatory requirements. It is important to note that the issuer or provider determines the identification required, such as Social Security number, Individual Tax Identification Number or foreign-issued identification to satisfy these requirements.[2] These cards can be reloaded as often as the customer likes and are frequently associated with payroll deposit programs.[3]

In addition, prepaid cards can be obtained from convenient retail locations, from self-service kiosks, over the phone, or via a web site. There is no necessity to visit a bank.

By working with the prepaid industry, transit agencies can provide bank card products to supplement payment media, allow all riders to enjoy bank card privileges, and reduce the agency's costs associated with the distribution and maintenance of closed loop transit cards, albeit by transferring some of these costs to the riders purchasing the prepaid cards. This approach has already proved to be feasible for serving riders that carry traditional credit and debit payment cards. Adding prepaid cards to the system would allow all riders to participate.

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[1] At the time of writing, certain financial institutions and payment networks are relaxing the rules on network-branded non-reloadable cards to allow a few load transactions up to a maximum value of a few hundred dollars.

[2] This requirement is a result of the U.S.A. Patriot Act and "Know Your Customer."

[3] Card program guidelines vary by payment network. The issuer or provider is required to monitor frequency and amount of card loads to satisfy Anti-Money Laundering regulations and may limit the amount. Refer to the card program's terms and conditions for rules about reload terms and restrictions.

While network-branded prepaid cards can be marketed directly by a bank or other financial institution, one significant difference between network-branded prepaid cards and traditional bank cards is that they typically involve a third party, commonly referred to as a program manager. The program manager is responsible for marketing and distributing cards and supporting the program. Transit agencies are understandably reluctant to take on this role as it can be costly and is an area in which they lack expertise. Discussions in the industry have therefore focused on cooperative relationships with program managers that focus on retail-based prepaid cards; the agency works with a program manager who can distribute cards at transit locations as well as in shops near those locations, so that people can buy a card with cash when they need one.

Transit payment represents an important opportunity for prepaid card providers as an effective means for growing a stable customer base. Because transit agencies can benefit from cost savings, there is a reasonable basis for cooperation. Furthermore, retail-based prepaid cards are very similar to the closed loop smart cards that agencies provide today, which can facilitate a transition to an open system for current patrons, the retail sales outlets currently selling transit passes, and the agency itself.

There are even more types of prepaid cards than the retail-based products mentioned above. The prepaid card industry is highly segmented. An agency should consider each product type, since each type can provide convenient access to a unique segment of the market. Each type has its own special circumstances, but all types share a number of commonalities. Understanding the similarities and differences can help an agency develop a strategy for open payment card distribution that ensures that every rider has or can easily get a fare payment card at no cost to the agency.

1.1.1 Card Technology: Contactless vs. Magnetic Stripe

State-of-the-art transit industry automatic fare collection (AFC) systems currently use contactless smart card technology for the fare media.[4] The prepaid industry, on the other hand, provides mostly magnetic stripe cards, not contactless cards. However, credit and debit card issuers are transitioning to contactless smart cards, merchants are installing contactless point-of-sale (POS) readers to accept contactless cards, and processors are making the infrastructure changes to support the added data elements required with contactless. Prepaid managers can leverage this infrastructure for new prepaid card programs.

To collaborate with the transit industry, prepaid program managers will need to cover the additional cost of a contactless smart card (as compared to a magnetic stripe card), but this additional cost represents only a moderate barrier to conversion, since processors and card suppliers can already support the technology. Prepaid program managers are unlikely to convert without a promise of a positive business case. Fortunately, the interest in open payment systems that transit agencies have expressed has been motivation enough for some prepaid card issuers to begin to offer contactless cards. Agencies are advised to contact several prepaid program managers[5] to solicit interest in supporting their programs.

1.1.2 Participant Roles in Network-Branded Prepaid Card Programs

The prepaid business model is structured differently from the business model in the credit or debit card industry. This section discusses the different parties that are involved in a major network-branded, reloadable prepaid card program and their roles in the process. It is important to note that one entity may perform multiple roles.

Figure 1 illustrates the roles of the different participants in the prepaid industry.

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[4] Additional information on transit fare payment systems can be found on the Smart Card Alliance web site, at
http://www.smartcardalliance.org/pages/activities-councils-transportation
[5] A good resource is the Network Branded Prepaid Card Association (NBPCA) member list,
http://www.nbpca.com/who_nbpca_members.html.

ISSUER
- Regulatory and payment brand compliance
- Payment brand relationship
- Funds settlement
- Card program owner

PROGRAM MANAGER
- Program design
- Marketing and customer solicitation
- Processor management (may be vertically integrated)
- Member service provider of issuer

PAYMENT BRAND
- License of payment brand marks and branding
- Transaction clearing system (between issuer and acquirer)
- Settlement of interchange

PROCESSOR
- Transaction processing
- Prepaid card program platform (including customer service and automated phone service)
- Ancillary features (e.g., bill payment, prepaid calling)
- Card vendor management
- Member service provider of issuer

LOAD NETWORK
- Channel for cardholders to add funds to their cards

Figure 1. Roles Played by Participants in the Prepaid Card Industry

The issuer is accountable for all aspects of the program, compliance with all applicable Federal and state regulations and laws, and compliance with the payment brand's rules. The issuer has approval authority over all aspects of the program. The payment brand considers the issuer to be the owner of the program. Subject to the payment brand's rules, the issuer must approve all parameters of the program, including maximum card balance, maximum daily transaction balances, number of periodic reloads, cardholder fees, and card art.

The program manager is the driving force behind the prepaid card program. Typically, the program manager designs the program and develops the business and marketing plans. The marketing plan includes a distribution strategy and, in most cases, a network of distributors. In conjunction with the issuer, the program manager sets the pricing and fees for the product. Program managers use their expertise in the market to develop alliances with strategic business partners and third-party vendors. The program manager must be registered with the payment brand as a member service provider for the issuer.

The payment brand sets the rules that must be followed by all parties of the transaction; the rules are typically defined in each payment brand's operating regulations. The payment brand also standardizes information about the components that reside on the card. From a transaction standpoint, the payment brand is responsible for connecting and routing the authorization transaction to the necessary parties, as well as managing the clearing system that is used to settle transactions and support interchange between the acquirer/merchant and the issuer. The payment brand organization reviews and approves or declines the card program submitted by the issuer. The payment brand supplies and configures the card program's bank identification number (BIN).

The processor is a member service provider (MSP) registered by the issuer to perform processing services. These services include the development of a platform for configuring and supporting the card program, performing cardholder customer service, acting as the system of record for prepaid accounts, facilitating authorization and settlement, providing reports to the issuer and program manager to manage the program, managing the interface to the payment brand's network, and implementing fraud and data security controls. The processor must be compliant with the Payment Card Industry Data Security Standard (PCI DSS, a set of standards designed to maximize data security).

The load network provides a channel by which cardholders can add funds to their reloadable prepaid cards through its network of retail locations. The initial load cost is included in the purchase price of the card, but for subsequent reloads, the load network charges the cardholder a fee and pays a portion of the fee to the merchant.

2   Prepaid Card Types

2.1   Common Prepaid Card Types

Prepaid cards can be divided into two basic types: non-reloadable and reloadable. A non-reloadable card is a card to which value cannot be added (one-time load[6]). A reloadable card is one to which funds can be added; it can be used on an ongoing basis. This is an important distinction, because whether or not the card is reloadable determines the regulations that govern the card program. In addition, there are two main usage scenarios, *open loop* or cards that can be used at any merchant participating with the card's payment brand, or *closed loop* where cards can only be used at a single merchant. While revenue-sharing opportunities are typically available for only open loop, general purpose reloadable cards, it is important to understand the many different types of cards in the market.

The open loop prepaid card industry has evolved to target many market segments. Within both the reloadable and non-reloadable categories there are many overlapping variations, including travel cards, gift cards, payroll cards, rebate cards, incentive cards, government benefits cards, general purpose cards, health savings account (HSA) cards, and flexible spending account (FSA) cards. Mercator Advisory Group[7] defines 33 types of prepaid cards encompassing a variety of markets. Each type can include both reloadable and non-reloadable cards. For example, the open loop cards sold in shopping malls are considered to be general purpose non-reloadable cards, while the Walmart MoneyCard is considered to be a general purpose reloadable card. Most of these types of cards could also be used to pay transit fares.

A prepaid card that uses the debit networks can be limited in where it can be used by restrictive authorizations. This method is used in pre-tax programs (e.g., healthcare spending and transit benefits) and in government prepaid programs (e.g., electronic benefits transfer). With restrictive authorizations, the payment networks can decline or reject transactions that appear to be inconsistent with the designated use of the prepaid card. Some prepaid cards are co-branded with a major retailer or group that has formed a marketing agreement with a program manager. Although there are certainly marketing benefits that can be achieved through the implementation of an affinity program tied to a specific transit agency, merchants must follow payment brand rules for acceptance. A merchant can determine which payment brands are accepted; however, if the merchant accepts a specific payment brand, then all cards bearing that payment brand mark must be accepted.[8]

The prepaid industry has developed this wide array of product types due to the utility of the bank card infrastructure that allows program managers to choose the pricing and features of the card and the target merchant acceptance, from a single merchant to all merchants participating in a payment network or somewhere in between. Importantly, the sophistication of the processing infrastructure allows all these products to use the same system. In this manner, merchants can use the same card acceptance devices that are used for American Express, Discover, MasterCard and Visa transactions to accept all types of prepaid cards. In fact, the clerk may not even know if the card is prepaid or not.

The safeguards provided by the payment brands through the issuer and processor requirements assure the integrity of the system and allow program managers to explore a variety of product types to develop successful programs. This flexibility has encouraged entrepreneurial activity and resulted in the wide variety of products.

Mercator's report aside, this white paper groups prepaid cards into ten types which are defined below.

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[6] See Footnote 1
[7] http://www.mercatorgroup.com
[8] Note that there are some exceptions to this (i.e., in the U.S., merchants can choose to not accept Visa Debit, but this must be clearly communicated at the point-of-sale).

2.1.1 Gift Cards

Gift cards are prepaid cards that have a consumer-defined fixed value and that are given as a gift. These cards can be *open* (the card can be used anywhere the designated payment brand is accepted), *in-store* (the card can be used only at a specific merchant), or for *distribution* (the card can be redeemed at specific locations and offers an experience, such as at a golf resort or spa).

2.1.2 General Purpose Reloadable Cards

General purpose reloadable (GPR) cards are prepaid cards that are purchased by a consumer to be used as the consumer chooses and that can have funds added to the card.[9] The cards can be used anywhere the designated payment brand is accepted or used for specific purposes. Examples of GPR cards that are used for specific purposes include *cards with limited acceptance* (e.g., fuel cards or movie cards); *open money and financial services cards* that are used for online purchases and offer a full range of services, from savings to bill payment; *money remittance/person-to-person (P2P) cards*; *business travel cards*; *events and meetings cards* where participants are provided with funds for use at the meeting venue and associated merchants; *relocation cards*; and *purchasing cards* (cards used by purchasing departments to purchase supplies or other similar items).

In addition, closed loop reloadable cards can also be used for specific purposes or limited acceptance (e.g., fuel cards, movie cards or spend cards such as the Starbucks card).

2.1.3 Government Cards

Government cards are used for the administration of government assistance programs. Rather than mailing a check to the benefit recipient, the federal or state government will contract with a program manager and issuing bank to provide prepaid cards to the benefit recipient. Each month, the agency will transfer the benefit amount to the prepaid card account of each recipient.

Examples of government-funded programs that use prepaid cards include Social Security, Temporary Assistance for Needy Families (TANF), Women, Infants and Children (WIC), state unemployment, and court-ordered payments.

2.1.4 Incentive Cards

Incentive prepaid cards are given by businesses to influence behavior. These cards are typically given to employees, clients, dealers, vendors, and consumers. Incentive cards generally fall into one of two categories: employee and partner, which are used to reward employees for a job well done; and consumer, which are used for purchasing products.

2.1.5 Campus Cards

Campus cards are prepaid cards that allow a university or other school to place financial aid refunds, book store refunds and work study pay onto the card. Based on the school's needs and capabilities, the card may also be used for additional functions such as student ID and meal plans. Students and parents can also add funds to the card for purchases.

2.1.6 Payroll Cards

Employers use payroll cards to deposit employee pay to the prepaid account if the employee does not opt for direct deposit to a bank account or does not have a bank account. An increasing number of employers are also offering payroll cards as a complimentary offering to traditional direct deposit to an existing bank account. This allows employees to be able to segregate a portion of their net proceeds for other purposes (i.e., spending money, additional savings).

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[9] Card program guidelines vary by payment network. The issuer or provider is required to monitor frequency and amount of card loads to satisfy Anti-Money Laundering regulations and may limit the amount. Refer to the card program's terms and conditions for rules about reload terms and restrictions.

2.1.7 Pre-Tax Program Cards

Pre-tax program cards are prepaid cards that deposit pre-tax earnings to a consumer's prepaid account and allow them to be used only as specified by current IRS regulations. Example pre-tax programs include healthcare reimbursement accounts, transit benefits accounts, and medical savings accounts. These cards are typically limited to use at several designated classes of merchants. For example, IRS rules prohibit the use of transit benefit funds for anything but commuting costs. This limitation can be enforced by restricting the use of the card to transit merchants through sophisticated approval systems provided by the processors.

2.1.8 Insurance Cards

Some insurance companies have begun to use prepaid cards for claims payment. The most common insurance applications using prepaid cards in their payment solutions are property and casualty and workmen's compensation.

2.1.9 Transit Cards

Transit cards are closed loop, reloadable prepaid cards and are used solely to pay for public transportation. Transit prepaid cards can be funded by a variety of sources.

2.1.10 Business Prepaid Cards

Business prepaid cards are ideal for employees, vendors, and consultants of companies who are not willing or unable to provide a corporate credit/debit card. The card can be used to pay for a range of business-related expenses including: business travel and entertainment, purchasing of goods and services, replacement for petty cash, business meetings and functions, expenditures specific to projects, and per diems for consultants and temporary employees. The card is best used when the company wants a more cost-effective method of payment versus cash or checks, when an employee does not meet the company's criteria to receive a charge, credit, or debit card, or when the company does not qualify for a charge or credit card.

3   Industry Metrics

Although it is difficult to obtain the number of prepaid cards sold annually, industry data makes one fact clear: despite the economic recession, open loop prepaid cards continue to grow in popularity as a method of payment. In fact, the recession may contribute to this growth.

The Mercator Group publishes an annual benchmark study that provides data for the prepaid industry. In the 6th Annual Network Branded Prepaid Market Assessment,[10] benchmark surveys and interviews of the issuers and processors who comprise the majority of Mercator's 33 prepaid market segments found the following:

- In 2008, loads for both open and closed loop programs totaled $247.7 billion, an increase of $27.8 billion over the 2007 volume of $229.27 billion.

- Network-branded solutions accounted for $60.42 billion in 2008, an increase of 48.6% from 2007.

- Open loop gift cards are increasing in popularity and penetrating the sales of closed loop gift cards. The open loop gift card segment increased by 54.3% over the previous year.

- Social Security benefits card programs have emerged from the pilot phase and are being rolled out. This segment accounted for $1.48 billion in loads in 2008.

In summary, the prepaid card market is growing at a healthy rate. However, the use of network-branded prepaid cards for mass transit is very limited at this time, although the opportunities exist for significant expansion.

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[10] http://www.mercatorgroup.com

4   Business Model Considerations

4.1   *Closed Loop Gift Cards*

The business model for prepaid cards for the transit industry can be viewed as being analogous to the retail gift card market.

So-called "closed loop" gift cards were developed to automate a paper-based system for issuing gift certificates, credits for merchandise returns, and other types of store spending. These manual processes were inefficient and susceptible to fraud. By moving to card-based programs, retailers could keep track of the number of cards issued and the amounts sold, redeemed, and held in accounts, and could also offer refunds for lost cards. Better tracking also allowed the retailer to manage float on the accounts (the amount loaded on a card that hasn't been spent) and escheatment responsibilities to the state. Card-based programs saved retailers significant amounts of money and provided their customers with more convenience than paper-based systems.

The products are called closed loop cards because they can only be used at the retailer who offers them. Because a transaction involving closed loop cards can only involve the retailer and its customers, the applicable economics and regulatory framework are different than for open loop cards, which can be used at any merchant accepting a payment network brand.

In a typical closed loop model, a retailer will contract with a processor who provides the stored value system and possibly the cards and packaging. The retailer pays a fee for the processing services, cards, and packaging, but the retailer can hold the funds and manage the float. Typically, a retailer need not upgrade or change any existing card acceptance equipment; however, the software in the POS POS devices must be updated to add this method of payment. Customers are typically not charged a fee for the card in these types of products.

4.2   *Open Loop Gift Cards*

Open loop gift cards use payment network branding to enhance the appeal of the gift. Why give a card that can be used only at one retailer, when similar products can be used at millions of locations? American Express®, Discover, MasterCard, and Visa all support such products, and one distributer reports that these dominate sales from its gift card mall.

The prepaid business model is structured differently from the credit or debit card industry. The program managers are seeking to earn a profit without offering credit or deposit services to consumers. Therefore, the programs require some form of fees.

Prepaid cards have several sources of revenue. In designing a program, the manager and the issuer who has ultimate responsibility for the program decide how to charge for the service.

4.3   *Open Loop Reloadable Cards*

4.3.1 Revenue Sources

Open loop reloadable cards have a number of revenue sources.

Cardholder Fees. Cardholder fees are an important part of the prepaid industry for consumer-oriented products. For example, program managers often charge a fee for the initial sale of their card. This is typical for cards sold directly to consumers such as gift cards, and general purpose reloadable cards.

Initial Fee (Card Purchase Price). Initial fees are shared with the distribution company and the retailer, in return for providing shelf space and restocking services. The initial fee is needed to ensure wide distribution of product. Program managers, however, need to ensure that the product is popular or the retailers will remove them in favor of more profitable offerings. Given the number of prepaid product choices, this market dynamic keeps fees at a moderate level.

Use Fees.[11] Most prepaid cards charge fees for various types of use, with a wide variety of fees and fee combinations depending on the program. The complexity of pricing is an issue that the industry needs to address. As programs mature, progress is being made and pricing is becoming more consistent; however, a wide array of fee types is available for managers to use to generate revenue:

ATM withdrawals, when allowed, typically carry a fee. ATM networks charge the issuer for the service so it is common to pass this fee to the consumer. Other use fees may include: monthly service fees, per use fee at retail, and reload fees.

Program managers typically use these fees to drive revenues, but they also charge for specific services such as mailing statements or replacing a lost card. Fees for GPR cards can typically be found on the card program web site.[12]

Interchange. A portion of the fee paid by merchants to their banks for card acceptance services is returned to the issuer of the card. This is called interchange and is part of the merchant discount amount that is collected by the acquirer during settlement processing. The issuer collects interchange fees and typically negotiates with the program manager for a share of these as part of their agreement to sponsor the program.

These fees are volume-driven, meaning programs where cards have significant amounts of money spent generate more issuer reimbursements than those with spending at lower levels. These reimbursements are set by the payment brands and are published on their websites. The percentages are small, requiring some managers to seek additional revenue (such as use fees mentioned above).

In contrast to retail-oriented cards, government cards are based on significant monthly deposits to each card account, making it possible for managers to generate sufficient revenues without user fees. ATM charges, however, are typical in this case for the reasons mentioned above.

Float and Breakage. Float is the amount of money that the program manager's bank holds from the time the card is loaded until the funds are spent. During this period the program manager's bank can treat these funds like other deposits and earn interest on the amounts. As in the case of the issuer reimbursement, the issuer and manager negotiate for a share of these earnings. While float can be a source of additional revenue, it is not currently a particularly lucrative source, given today's interest rates.

Breakage refers to any amounts of money that are abandoned by the cardholder. These amounts can be recognized by the program manager as income subject to escheatment.

Inactivity Fees. Some programs will charge inactivity fees. These fees are assessed after a defined period of time when the card has not had any activity. The period and fee varies from program to program.

4.3.2 Revenue Sharing

The common model for realizing revenue in a prepaid program is through a "revenue share" arrangement where, as the name implies, revenue is shared between the program manager and the merchant/retailer. Transit agencies stand to benefit as the "retailer" of cards sold from their locations. The retailer receives a percentage of the revenues earned by the program manager. This percentage is typically negotiated and can involve one or more of the program manager's revenue sources. In general, the more cards issued and the more use made on each card, the more revenue is available for the program manager. Total revenue therefore depends on the number of active cards in the program. Savvy transit agencies will work with program managers to maximize earnings, use revenue share to offset costs to vulnerable population riders, or provide incentives to transition to prepaid cards from cash.

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[11] It is important to note that new legislation may affect some types of prepaid cards; program managers are responsible for making sure that their programs are in compliance with such regulations.

[12] Walmart Money Card (http://www.walmartmoneycard.com/), Green Dot Card (https://www.greendotonline.com/), Netspend Pay as You Go Card (https://www.netspend.com/) and ReadyCard (http://myreadycard.com/) are examples of popular GPR cards.

4.4 Compliance and Regulations[13]

The compliance environment in which prepaid cards operate is evolving. Additionally, it can be difficult to define which of the regulations that govern traditional deposit accounts also apply to prepaid cards. Some card issuers take a very conservative approach and treat prepaid card accounts like deposit accounts, while others make a clear distinction between the two account types. Guidance from regulatory agencies may or may not single out prepaid products. Prepaid card programs must develop their own risk-based compliance plan.

As a general guideline, issuers and program managers must consider regulations that could possibly apply to prepaid cards in the same way as to other deposit accounts. Examples of compliance requirements to consider when developing a prepaid card program are discussed in Appendix C.

The compliance and regulatory environment in which network-branded prepaid cards operate is driven by whether they restrict use or are open loop. As long as a card is a one-time card (e.g., an open loop gift card or a manufacturer's rebate card), the owner of the card is not considered to have established a formal banking relationship or account with the issuer. Non-reloadable cards are therefore subject to different rules than reloadable cards. They are typically anonymous and do not fall under the same rules as a card that may be reloaded and used at multiple retail establishments. An individual can purchase them on behalf of another person and they may be purchased and used by minors without parental consent. This is not necessarily the case with an open loop, reloadable prepaid card. However, when someone purchases an open loop card to which value can be added, the purchaser is considered to have established a formal banking relationship with the issuer. The card is therefore subject to the banking regulations that pertain to the bank's deposit accounts. Fortunately for transit agencies, it is the issuer's responsibility to provide compliance oversight.

Reloadable bank-issued cards are subject to the Bank Secrecy Act of 1970 (BSA) and the USA PATRIOT Act of 2001, which require certain information to be collected from the cardholder. They are also subject to Regulation E, which governs electronic funds transfers, and a host of other regulations with which compliance is required by bank examiners.

When a cardholder registers to reload the card, the cardholder must provide information to verify the cardholder's identity (Know Your Customer or KYC). The name of the purchaser is scanned against the Office of Foreign Assets Control (OFAC) Specially Designated National (SDN) list. At a minimum, the cardholder must provide a name, physical address, date of birth, and, if a U.S. citizen, a tax information number or Social Security number. If the purchaser is not a U.S. citizen, the bank may choose to accept alternative documentation, such as a Matricula card, as a substitute. The specific requirements are set forth in each bank's Customer Information Program (CIP). Although the phrase "all are accepted" is commonly seen on marketing materials for reloadable prepaid cards, it is important to note that the statement usually includes a caveat, "Subject to the USA PATRIOT Act," as those on the OFAC list are unlikely to be provided a card.

It is important to note that the legislation governing prepaid products is constantly changing. Program managers and banks are constantly reviewing regulations when implementing a prepaid program.

There are many state laws governing key aspects of prepaid card programs. Some states have regulations governing fees, expiration dates, and even font sizes. While such laws may not apply to nationally chartered institutions ("federal pre-emption"), it would be advisable for any prepaid issuer to seek the advice of their legal counsel regarding the applicability of these state laws, in addition to federal regulations. Further information regarding state laws can be found at: http://www.multistatetech.com/svc.

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[13] This section is intended to provide an overview of the compliance environment for prepaid cards. The Smart Card Alliance and its members do not intend that this section be used as legal advice. Transit agencies should consult with their legal counsel for guidance on applicable regulatory compliance requirements.

4.5   Distribution Methods

There are several methods for distributing prepaid cards to consumers. Typically, cards are distributed by the issuer or merchant (or transit authority) or through national third-party distributors. Specific distribution methods include:

- J-hook sales at merchants or financial institutions. These are retail displays that present prepaid cards in packaging that hangs from a hook that is shaped like the letter "J" to allow easy selection by the consumer. These are often combined in a retailer's gift card mall displaying several types of cards. The package is typically taken to the check-out counter where the clerk accepts payment, activates the card and loads the initial value.

- Cardholder mailings to registered consumers. The preferred method for distribution to an existing customer base is by mail.

- Issuance by employers, universities, and other organizations. In certain cases, program managers can enable other parties to activate cards at the time of sale. Issuance may also include equipment to add pictures to the card for other purposes.

- Internet / mail / phone order. Many program managers offer consumers the ability to purchase cards online and have them mailed to the purchaser's home or business.

- Kiosk sales machines. Self-service kiosk sales allow consumers to insert cash into a slot and receive an activated card for the amount presented, less any initial fee. These machines offer a simple interface and multi-lingual capability and are similar in construction to ticket vending machines in transit.

4.6   Reload Methods

Cardholders add funds to the balance on a prepaid card by reloading the card. Unlike traditional deposit accounts, the issuing bank does not generally accept such funds at a teller window or ATM. Instead, prepaid cards are loaded through other channels. Some issuers do allow cards to be reloaded at ATMs.

In certain cases, prepaid card programs can offer the use of debit and credit cards as a funding mechanism, but the most common means is with cash or automatic deposit of payroll or benefit amounts. Owners of prepaid cards do not generally have debit or credit cards. Thus, adding funds with a credit or debit card carries a high level of risk of fraud as a criminal may "launder" a stolen debit or credit card by using it to purchase a prepaid card.[14] Therefore the majority of reloads are done with cash or with funds transferred from a bank account. PayPal can also be used as a reload channel.

The most common method of reloading a prepaid card is through cash payments at retail locations that are part of a reload network. MasterCard, Green Dot, MoneyGram, and Western Union have the largest number of reload locations. There are also smaller reload systems, such as Empasys. Program managers typically contract with these systems to provide convenient reload points for customers.

Transit agencies can take advantage of this infrastructure by combining their locations with an existing reload network rather than relying solely on their own reload approach. The reload application is on a personal computer, not a POS terminal, so the addition of the service may not require any additional equipment. The funds are available to the cardholder immediately.

The use of direct deposit should also be promoted and encouraged by the program manager or issuer. Persuading the cardholder to have wages or government benefits payments directly deposited to the prepaid card account ensures a steady stream of funds and higher average balances, and could increase cardholder retention. All of these factors can lead to enhanced profitability for the prepaid card program.

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[14] "Prepaid Cards; Vulnerable to Money Laundering," Stanley Sienkiewicz, Federal Reserve Bank of Philadelphia, February 2007, http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2007/D2007FebPrepaidCardsandMoneyLaundering.pdf

4.7 Prepaid Card Relevance to the Transit Industry

As transit agency fare collection systems have evolved, acceptance of traditional magnetic stripe credit and debit cards as payment for smart card, magnetic or other fare media has become the norm. With the advent of contactless smart card technology, more and more agencies are updating their systems to use smart cards. However, most all of these implementations are closed loop transit-only systems, where credit and debit cards are used to pay for and reload value to the closed loop contactless fare media.

As the payments industry begins to incorporate contactless technology into credit, debit and prepaid cards, transit agencies are considering using these contactless cards to replace or supplement current fare media as a means of opening up their closed loop systems and achieving operational efficiencies and savings. However, meeting the needs of all riders requires a broader reach than is possible with traditional credit and debit cards. Some consumers do not want or cannot obtain credit or debit cards and therefore cannot participate in a traditional financial product-driven approach to fare collection that is limited to credit and debit products only. Prepaid cards provide a means for the transit agency to cover the diverse needs of the ridership and meet the various needs of its constituents. As a result, prepaid solutions are highly relevant to an agency planning to introduce open payment systems based on banking products.

This section summarizes some of the issues an agency should consider in making the decision to offer prepaid cards using bank card standards or to offer a transit payment application using traditional offline technology.

In a closed loop transit payment transaction, the terminal or reader reads information from the transit smart card and writes the result of the transaction back to the card to indicate the completion of the fare payment. For example, the reader will note the cash balance stored on the card. It will then deduct the fare for the desired trip from the amount and return the new cash balance (initial balance less ride cost) to the card. This approach is not possible in bank card systems as current payment cards do not carry balances on the card or support a write-back capability to the network-branded payment application.[15]

In current contactless AFC systems, the card interacts directly with the reader and fares are calculated at entrances or exits (or both) based on information downloaded to the devices from a data center. If an agency wishes to add bank cards to its current program, they may also decide to offer their legacy smart cards to those customers who do not have contactless bank cards. However, an agency could also decide to use network-branded contactless prepaid cards to achieve the same market coverage. This strategy would enable a single technical approach to serve all riders.

In a transit system accepting contactless bank cards, the card reader is connected to a data center using a communications network. The card is read by interacting with the reader, and the back office server usually determines whether the card is valid. The local device can also make a determination of the card validity, especially if the communications network is unavailable at the time. Cards may be registered to an account on the transit system which may hold valid fare products. Registered cards can be logged in a positive list for local and/or centralized validation. For cards that are not registered (or that have depleted transit accounts) a "pay as you go" transaction can be accepted with the fare calculated in the back office; in this case, the transaction is submitted to the network for processing, either individually or in aggregate with other fares. Accordingly, the contactless bank card can support the full range of transit products and fare policies. What differs is the system architecture.

Agencies that are considering whether to accept any network-branded contactless card – credit, debit or prepaid – in their systems need to understand the operation of both their current AFC system and the prepaid program system. The most important difference is the need for a robust communications network

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[15] There are implementations where a proprietary transit payment application is resident on a contactless bank card; in these cases, the transit payment application can support write-back. Examples include Transport for London/Barclaycard and Taiwan MoneyCard/KCG. Additional information on this approach can be found in the Smart Card Alliance white paper, "Co-Branded Multi-Application Contactless Cards for Transit and Financial Payment," March 2008, http://www.smartcardalliance.org/pages/publications-co-branded-multi-application-contactless-cards

to ensure the readers can talk to the back office system at virtually all times, in order to process fares and record transactions in the back office rather than on the card and reader.

Secondly, the integration of legacy and bank card-based systems should be considered. For example, the type of reader used by the transit agency will affect the complexity of moving to open loop contactless payment cards. An agency's current system may incorporate a reader supporting closed loop proprietary specifications (both physical and application level), open standards (such as ISO/IEC 14443 physical, Contactless Fare Media System (CFMS) or contactless payment application level standards) or both proprietary specifications and open standards. To support open contactless payment transactions, the reader must be certified by a payment brand-approved test house.

Systems that use readers that are compliant with the ISO/IEC contactless standard and that are not payment brand-certified will most likely need to have the reader's firmware updated. After the reader's firmware is updated, a system test must be conducted (in addition to completing the certification process) to ensure that the firmware change does not affect the system negatively.

The simplest systems to expand to include prepaid contactless cards are those that already incorporate certified readers or have readers capable of the type of firmware update mentioned above, as these readers are approved for interacting with contactless bank card products. In this type of system, the required changes are establishment of the transit account management platform, fare processing engine, and customer service utilities within the transit back office complex or with a third party service provider who manages these functions. This processing approach must be designed to support the acceptance of both cards registered with transit accounts (for specialized user groups and fare categories) and unregistered cards owned by consumers who wish to perform one-off payment transactions similar to those typical of a POS environment.

If an agency's reader base is limited to proprietary specifications, the readers will need to be either modified or replaced. While in some cases it might be simpler to install a parallel certified contactless bank card system separate from the legacy system, there are suppliers who offer readers capable of supporting both legacy (proprietary and published) specifications and contactless payment standards, thus facilitating an orderly and seamless introduction of open payment cards. In either case, the card-based and account-based back office systems can be tied together by exporting data from the legacy system into the newer system's back-end controller to run consolidated reports.

Once the system has been modified to accept bank cards, the agency can then decide how aggressively it wants to be in eliminating closed loop fare media in favor of bank-issued products. As discussed in the next section, a market analysis can be done to determine the state of contactless bank cards in the area. The prepaid industry can offer transit agencies a variety of products that are available today. However, the agency may wish to continue to offer its own product for employees and special groups or for other reasons. Another option for the agency is to consider a hybrid, co-branded approach, where the closed loop transit application is added to an open loop, standards-based contactless bank card. This would support the integration of the agency's own product with open loop bank cards in the market.

4.8 Closed Loop Contactless Prepaid Cards Using Bank Card Standards

Closed loop prepaid cards are redeemable only at specific locations. The location may be an individual merchant or group of merchants, such as a mall. Closed loop prepaid cards are often retailer-specific gift cards, which have replaced paper gift certificates.[16] Closed loop card programs retain virtually all of the functionality of an open loop card program while providing organizations with an efficient and flexible method of handling payments electronically. Closed loop programs differ from open loop programs in several ways: for example, the issuer of the card account and the acquirer of the transaction are usually the same organization, and funds for the transaction do not leave the organization. Also, the transactions are not subject to the same set of regulations, program rules and fees as open loop card programs.

The rules, regulations, and operating guidelines for closed loop programs are often simpler. A major factor in closed loop programs is that these programs do not have the same expense components as

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[16]   Prepaid Best Practices, MasterCard white paper, May 2008

open loop programs. For example, in an open loop program, discount rates and other fees are paid by the merchant to the various parties that are involved in the payments processing process. The acquirer or merchant service provider will collect these fees as they have the contract with the merchant. In a closed loop program, these expenses either do not exist or can be levied by the organization implementing the program. In closed loop programs, however, other expenses are incurred that are not required in the open model including: card procurement and distribution, cardholder customer service, program marketing, and reload capability.

There are currently a variety of closed loop programs, most of which are not associated with a particular payment brand. Organizations choosing to implement a standard commercial card program that is limited to specific individuals or organizations and that can only be used at specific locations generally choose to license a BIN from one of the card payment brands. This means that the primary account number (PAN) will follow the brand's established numbering scheme (e.g., begin with a 4 or 5 for Visa or MasterCard respectively), and support many of the standard commercial program features and functionality. The card payment brand that licenses the program will typically charge the program manager a fee for the license. This fee is intended to cover both setup and allocation of the BIN range to the specific program and any other administrative services provided to the program owner. BIN licensing also ensures that the card program will function much like an open program, and therefore most processors who run open programs for issuers have the technical capabilities to support closed programs.

One important consideration in considering whether to institute a closed loop program is the funding and settlement process. The funds provided to a closed loop prepaid program owner may be governed by banking regulations, and therefore processes must be in place to manage this aspect of the program and provide the consumer protections required by law.

While several transit agencies have already implemented closed loop contactless cards, these programs are either proprietary or leverage transit industry standards, not bank card formats or standards. This may limit the flexibility of the organization owner (in this case a transit agency) to adapt to changing technology, processors, and media, since the card is not based on open commercial standards, as a closed loop, network-branded payment card would be.

5   Transit Use of Prepaid Cards

The variety and number of prepaid programs in today's market provide transit agencies with several opportunities to expand beyond credit and debit acceptance and build a strategy of providing some type of third party card suitable for all its ridership. Although there are certainly marketing benefits that can be achieved through the implementation of a transit agency prepaid program, the payment brands' "honor all cards" rules requires merchants to honor all cards, with some exceptions. A merchant accepting a specific payment brand must accept all cards with the payment brand mark.[17] This section offers suggestions for steps that transit agencies should take in planning use of network-branded cards.

First, the number of credit and debit cards held by riders should be determined. Several agencies have reported that a significant portion of their riders already carry bank cards. In addition, determining the number of contactless cards in this population will indicate how many riders are already able to use a bank card-based system. This will help determine whether a program will need to take an aggressive approach to promoting the card.

Agencies should approach several local banks to discuss their contactless conversion plans. Most banks market credit cards nationally but debit cards tend to be more local since they are based on accounts held at the bank. Discussions with banks in the area will help the agency understand the pace of contactless card issuance in the agency's service area. In addition, the payment brands provide merchant acceptance information on their web sites.

Agencies should approach prepaid card program managers to discuss their contactless conversion plans and interest in supporting a transit program. Agencies can work with program managers to provide cards for unbanked riders through retail and transit location sales; prepaid cards may offer the fastest implementation of a network-branded bank card if there is a low penetration of contactless credit and debit cards in the agency's regions. The existing infrastructure for prepaid card distribution can support thousands of sales locations with little or no agency involvement.

Discussions with transit benefits providers are also important, since many of these companies are already issuing prepaid cards instead of paper passes and may be willing to convert their programs to contactless cards if the agency is moving in that direction.

Government benefits cards require the support of the issuing government agency for any change to contactless technology. However, it is likely that public transit is an important service for the benefits recipients. Gaining the support of the benefits agency is important to converting these cards to contactless.

In a similar fashion, student ID cards may already be based on a prepaid program. Discussions with local institutions will reveal how to convert school ID cards to fare media.

Finally, the agency can choose to issue its own card. In this case, the agency may choose to offer a closed loop card based on bank card technology so that no additional system requirements will be needed. In this case, the agency could work with a program manager to outsource this product or become a program manager in its own right.

To develop prepaid programs most easily, transit agencies can work with one or more of the program managers who are interested in transit customers. In this model, the agency negotiates with the program manager to establish the most appropriate product features and pricing. The agency may be asked to provide fare incentives or other transit benefits to cardholders to improve the appeal of the product. Revenue sharing and the provision of other marketing support are appropriate topics for the parties to discuss. Once the program is defined, all operations are outsourced to the program manager. The agency benefits in this model by retaining control of the public portion of the product without having to develop new capabilities internally.

Agencies can also be their own program managers. With this approach, in addition to determining proper fees and prices, agency staff must negotiate with a bank to agree on a BIN sponsorship contract, secure

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[17] Note that there are some exceptions to this (i.e., in the U.S., merchants can choose to not accept Visa Debit, but this must be clearly communicated at the point-of-sale).

a certified processor to manage the transactions that are generated by card sales, card loads, and card use, and support customer service requirements. Usually one entity can provide a complete package of services for program managers. The agency must also negotiate with a distribution company to support sales of cards at retailers.

5.1 Revenue Share Potential

For any prepaid program, the issuer, program manager, and processor must cover their own implementation costs so that the agency can enjoy a sustainable revenue share. Components of a revenue share typically consist of a percentage of some or all of the following:

- Spend or load amounts
- Interchange (for network-branded transactions)
- Fees
- Float[18]

The success of any program depends on the number of cards distributed, the amount of funds loaded and redeemed on a card, and the amount of time (number of months and years) a patron uses the card. A healthy revenue share is also directly related to the amount of support the prepaid manager receives from the agency in distributing and encouraging the use of the card.

5.2 Business Case Considerations for Conversion to Contactless Prepaid Cards

Many transit agencies are looking to accept network-branded open loop payment cards as an alternative or a complement to the transit-only closed loop smart card. Contactless payment cards (and other devices, such as key fobs and specially-equipped mobile phones) use a contactless smart card chip and antenna that can transmit information to a contactless-enabled POS terminal located within a few inches of the card.

Contactless smart card technology is more secure than RFID technology and can be added to traditional magnetic stripe cards. A contactless bank card also has a magnetic stripe to ensure use at merchants that do not have contactless payments capabilities.

Contactless smart card technology has also been implemented in sticker form and can be attached to other items (such as a mobile phone or magnetic stripe employee ID) to enable its use in retail stores or in transit systems if open payments have been adopted by the agency. These stickers can contain bank card numbers as well.

Contactless payment capability can increase the attractiveness of a prepaid card to the cardholder. In addition, integrating payments with a consumer's mobile phone is expected to be a popular service due to the convenience it offers consumers. Any business case for implementing a contactless program or converting a magnetic stripe program to contactless should consider the potential for multiple devices being used to initiate payments against a prepaid account. Since all devices will be required to comply with bank card standards, adding new devices will be easy to implement when the time comes.

The basic costs and revenues to include in a business case are the same as those associated with a traditional magnetic stripe program. To these must be added the incremental costs associated with a contactless program, including:

- The increased cost of the contactless card. The chip adds cost to a card. In addition, some payment brands may require that alternative form factors (such as key fobs and mobile phone stickers) come with a companion card, because the alternative form factors lack magnetic stripes and would otherwise be unusable at ATMs or POS terminals that don't have contactless capability. The added expense of the contactless card can be an issue, especially for low-value non-reloadable prepaid cards.

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[18] Depending on the approach, the holder of the float will change.

- Processor certification for contactless card transaction processing. The program manager's processor must be certified for contactless card processing.

The total cost for converting a magnetic stripe-based prepaid program to contactless is primarily due to the moderate incremental cost for the chip.

There is considerable discussion in the industry about the popularity of mobile phones among the unbanked. This leads to the question of whether or not a phone-based approach could assist in covering the ridership of an agency. The following are hurdles to using mobile phones:

- The cost of NFC-enabled mobile phones. The number of handset models with NFC capability is limited. There is also an additional cost to personalize cardholder account data, which is accomplished over-the-air through a process that involves SMS text messages and application download. The phone owner pays for this time and the cost of the application.
- The availability of NFC-enabled mobile phones. At this time, no NFC phones are being sold in the U.S. market, although this is expected to change in the near future.

A more universal way of adding contactless payment capability to a mobile device is to use adhesive tags (i.e., stickers) that can be attached to any mobile device. The stickers are personalized by a certified card vendor and are electronically identical to any other contactless card. The cost of the stickers can be modest and provide a bridge to mobile phone users who do not have bank cards.

Program managers may pass the extra cost to the consumer in the form of higher purchase fees. This can be offset by providing free rides for those riders who select a partner's prepaid product.

5.3   Transit Agency Riders and Prepaid Card Programs

A large number of prepaid programs are currently established, with more being launched. Many of them offer attractive fees and value-added features. It therefore cannot be assumed that if a transit agency offers a prepaid program, riders will automatically choose it as their preferred payment method.

To motivate riders to use a transit agency card program, the program must stand out from all other programs. In addition, the program's primary goal of the program is for riders to use the prepaid card instead of cash. Therefore, the benefits of using a prepaid card must be very obvious to the cardholder. These benefits can include:

- The ease with which purchases can be made
- Ability to use the card for Internet purchases
- No need to carry cash
- No liability for fraud
- A convenient reload network
- Low fees
- Use as a direct deposit vehicle for payroll and government benefits
- Rewards, discounts, and promotions (which may or may not be tied to ridership)
- Low-cost prepaid calling
- Mobile access, contactless, web browser, and SMS features
- Low-cost card-to-card transfers to avoid high remittance fees
- Healthcare and pharmacy discounts
- Credit builder facilities
- Designation of a portion of the transaction for a charitable organization

The list is already extensive, and prepaid program managers are always trying to add new benefits to entice consumers to acquire their card.

5.4　Role of the Agency vs. the Role of the Program Manager

Agencies will find that the more they participate in the development and implementation of the program, the more successful it will be. The more successful a program is, the greater the revenue for the stakeholders. An agency needs to promote the card, find the means to distribute it to the agency's riders, and incent riders to use the card.

5.5　Maximizing Income

Agencies and program managers are partners in a transit prepaid card program. How active each partner is depends on the terms of the contract.

Agencies must realize that they are not entitled to share in program revenues without sharing in the responsibility for the program. Too often, affinity partners think that they are going to receive revenue, but are unwilling to assume responsibility for any aspect of the program. The actual terms of revenue sharing can vary greatly, depending on negotiations between the agency and program manager.

The strategies for maximizing income for transit prepaid cards are no different than the strategies used to maximize income for any reloadable prepaid card. They include the following:

- Encouraging use. Maximizing use maximizes revenue generated by the prepaid card program. The interchange revenue can be shared between the program manager, agency, and even the issuer and is negotiated by the three parties. Spending can be encouraged through incentives, rewards, and sweepstakes.

- Increasing customer retention. Prepaid cards can have high abandonment rates, and the cost of issuing a card is high. Maximizing revenue requires cardholder retention. Cardholders do not have a multi-faceted relationship with either the program manager or the issuer.

  To increase "stickiness," it is important to make the card convenient to reload and use. In addition, cardholders should be provided with a good online cardholder experience and good telephone customer service experience. Implementing robust customer self-service minimizes the use of live customer service agents.

- Finding ways to increase average balances. Although most issuers do not share earnings on deposit (float), earnings on deposit are a component of revenues. These amounts are currently not very significant because interest rates are at historical lows and the balances on prepaid cards usually average no more than $150. However, average balances can be boosted by proactively promoting direct deposit and offering bill payment features.

- Increasing revenues by offering other value added services, such as long distance calling. The revenue split between the program manager and the agency for these services would be determined by negotiation.

- Charging cardholder fees. Charging fees can pose problems for a transit agency's reputation. However, transit agencies would need to subsidize a program if the cards were fee-free.

- Minimizing fraud losses through strong controls.

6   Lessons Learned from Prepaid Programs

The use of prepaid cards for fare payment involves many of the same considerations that agencies must address in a typical system. Decisions include where and when the cards are initially sold and when and where value can be added to the cards. These considerations are relevant regardless of whether a transit agency partners with a prepaid card program manager, becomes the program manager and issues prepaid cards in partnership with a bank and processor, or issues a traditional transit-only based smart card.

Previous implementations indicate that the following considerations (discussed below) affect the success of a prepaid transit card program:

- The reliability of the program
- Program compatibility with the current payment processing infrastructure
- Program security, protecting against fraud and guarding privacy
- Marketing effectiveness to achieve threshold numbers
- Card funding approach
- Public perception of the fees involved
- Settlement and clearing (payment to agency / billing to rider)
- Implementation
- Level of merchant recruitment and training
- Compliance requirements
- Level of support services provided

6.1   Program Reliability

Reliability and dependability are essential to offering any prepaid card program as an alternative to transit riders. In addition, reliability and dependability are vital for public acceptance of the prepaid card program and sanction by public boards.

As with any smart card program, the card readers and backend infrastructure must be reliable. The impact of breakdowns is the same in either case – consumer inconvenience, revenue loss, and bad press.

Prepaid bank cards are based on the same technologies and systems that operate the global payments system for credit and debit cards. These are well-proven systems that offer a level of reliability that should support transit agency standards. All stakeholders in the prepaid program need to work to ensure the reliability of the system.

6.2   Compatibility with Payment Networks

The ability of a prepaid card program to offer customer-friendly and cost-effective approaches to serving transit riders contributes to the program's success.

Ensuring compatibility with the current payment network processing infrastructure and processes is vital to obtaining these cost savings. This infrastructure includes both back-end electronic payment processing systems and merchants' in-store infrastructure. Over time, the financial services industry has built and now maintains a reliable, proficient, and economical electronic payment processing infrastructure that supports all types of cards with equal rigor – credit, debit and prepaid. Prepaid cards use this system for initial sales as well as reloads at retailers nationwide. Duplicating this effort for a transit-specific closed loop prepaid card program is neither cost effective nor necessary.

In contrast to prepaid programs that use existing systems, establishing a network that both sells and allows a fare value be loaded to a transit-only smart card typically involves deploying a standalone POS terminal and potentially integrating with existing merchant systems. Merchants are generally reluctant to make major process or system changes without significant compensation. For example, the Washington

Metropolitan Area Transit Authority (WMATA) SmarTrip® and San Francisco Bay Area TransLink® programs required participating stores to install agency-specific POS terminals on the countertop using anti-theft hardware. These attended POS devices could handle only analog communications; several of the store chains that were participating or wanted to participate in the program no longer had either the infrastructure or the equipment to support analog communications.

Prepaid cards, however, are well established in thousands of retailers. Merchant and processing infrastructure problems do not exist since the bank card systems are already in place.

6.3 Security

In selecting a program manager, agencies should pay attention to risk mitigation programs that are in place. Fraud rates can be a concern for prepaid card issuers. While transit agencies are shielded from these losses, choosing a partner that is skilled at preventing fraud is good business practice. For example, criminals can use stolen credit or debit cards or checking account numbers to purchase prepaid cards, in effect laundering the stolen cards into valid currency. Prepaid program managers must monitor transactions vigilantly to identify and control fraud. Monitoring can be done based on filtering (use of lists of bad cards and good cards) or rule-based algorithms. To discourage counterfeiting and skimming, card design should include fraud prevention elements.

Prepaid cardholders are not always guaranteed that they will recover all of their money if a card issuer fails. Agencies should choose program managers and issuers that offer protection for consumer balances. Consumers using prepaid cards must have peace of mind that their money is safe if the card-issuing entity fails.

Prepaid card accounts can be funded by transferring funds from a different bank account or a credit card; however these methods are rarely used when a card is first "purchased" by an unbanked individual. Because unbanked consumers may have an affinity for privacy and anonymity, load networks must allow cardholders to make cash deposits at retail outlets or vending machines, albeit for a fee. Load networks must be regulated as money services businesses and comply with all Federal and state laws (discussed in Appendix C) and use PCI DSS certified systems that are required by the payment brands.

6.4 Marketing

A total of 300,000–500,000 active prepaid cardholders is the suggested threshold at which economies of scale begin to optimize pricing structures that are both affordable for cardholders and profitable for the prepaid card issuer.[19] Cooperation between the program manager and the agency can help meet this target. Smaller agencies may consider taking advantage of the open nature of bank cards by joining with other agencies to combine forces toward this target.

Initial marketing campaigns should be aimed at the segment most likely to be receptive to new technologies and payment systems. A strategy to build an initial customer base is to find the transit riders who are receptive to new technology and who are more likely to be early adopters.

Agencies should consider the following marketing strategies:

- Promote the program to the all riders and develop ongoing marketing programs to build awareness and drive use.
- Encourage use of the autoload feature, by waiving or discounting the card acquisition fee for any customer who sets up a payroll deposit or similar funding source at the same time that the customer acquires a card.
- Offer a rebate for initial trips to customers who purchase cards at retailers. The purpose of such a rebate is to remove one possible barrier for lower income transit riders using the prepaid card.
- Offer soft benefits for using the prepaid card. For example, WMATA bus rides cost 10 cents less if the customer uses the SmarTrip® card rather than cash to pay the fare.

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[19] "The Race Is on in Prepaid," Mark Beresford and Steve Karp, Edgar Dunn & Company white paper, September 2007, http://www.edgardunn.com/uploads/100030_english/100232.pdf

6.5   Closed Loop Card Funding

In traditional automatic fare collection (AFC) programs, agencies must provide a means by which to load value onto their closed loop transit-only prepaid cards. Autoload programs are very popular with riders, due to their convenience. However, autoload requires linking the transit card to a funding source, typically a bank account or payment card.

Public officials frown on systems that are unavailable to certain riders because the riders do not have traditional bank accounts or payment cards; yet building a transit-specific load network is expensive and challenging. Transit agencies have had to work hard to establish and maintain sufficient coverage for all riders. Agencies may be able to better serve low income transit riders by offering the option to use open loop prepaid cards to add funds to closed loop transit cards. For example, why not use a prepaid MasterCard to autoload a Houston Metro Q Card?

Payment network-branded prepaid cards can be easily loaded using the industries' extensive load networks. Whether at staffed load stations, such as retail locations, or unstaffed load stations, such as kiosks that accept cash, transit customers will find hundreds of locations to convert cash to card value. Once riders have a prepaid bank card, they can set up the autoload function to replenish fare value on a closed loop card.

If the rider chooses a contactless network-branded prepaid card, the same can be achieved in one step once the agency has added acceptance to their system.

6.6   Card Sales and Considerations

Considerations for building a sales and load network for closed loop transit-only payment cards includes recruiting and training merchants and installing and maintaining POS equipment. Transit riders will not be able to access any transit smart card and gain the benefits of its use without excellent geographic coverage and an immediately recognizable set of region-wide retailers. Agencies will have to persuade stores to participate in the program, which initially is likely to have little brand recognition. Additionally, agencies like WMATA do not allow existing sales outlets to charge commission rates or transaction fees for sales of its products. Merchants are willing to take on transit card sales in return for opportunities to increase foot traffic from their target demographic; however, in some geographical areas, it may be difficult to persuade merchants to participate in a prepaid card program without some form of financial incentive.

In contrast, the prepaid industry has well-established pricing for retailers engaged in selling or loading value to prepaid products. These costs are often much lower than agency costs for its own system.

6.7   Settlement Considerations

Persuading sales outlets to settle all transactions daily was a cornerstone of the San Francisco Bay Area TransLink system. In many cases, retailers kept the agencies money for several days as a form of compensation for selling transit products.

In the prepaid industry, fees are established and are based on consumer payments to the program manager. Once the agency has agreed to the card pricing with the manager, gaining retailer support can follow. Settlement to the prepaid processor is done on a daily basis.

6.8   Consumer Card Fees

Fees associated with the prepaid cards can often be confusing, and cardholders can feel that they are being "nickel-and-dimed." Examples of fees associated with prepaid card programs are:

- Initiation or activation fees
- Monthly fees
- Fees to add (load) funds
- POS transaction fees

- Cash withdrawal fees
- Dormancy fees

To facilitate widespread adoption of the cards, transit agencies should work closely with the program manager to design the pricing and feature set for the prepaid card. The following are points that agencies should consider:

- Where appropriate, bundle fees and provide clear explanations of the fees.
- Display fee information in plain sight in a simple, comprehensive chart.
- Implement card giveaways or some form of rebate. For example, provide a free day pass for all prepaid card buyers in the month of January.
- Provide reports on transactions to consumers on the Internet and to card sales merchants in both paper and digital form. Riders, especially unbanked riders, should be given the option of receiving monthly paper statements for a nominal fee.
- Conduct research on the demographics in the transit agency's area.
- Have trained customer support specialists available 24 by 7 by 365 to help participating merchants and riders.

7   Conclusions

Many transit agencies are looking to accept network-branded open loop payment cards as an alternative or complement to the transit-only closed loop smart card. To achieve this goal to date, agencies are relying on banks to convert credit and debit cards to contactless technology for all of their banking customers. However, banks do not serve all transit customers and a fare payment system that does not reach all riders is not acceptable.

The prepaid card industry has grown rapidly over the past several years and can now offer transit agencies the ability to supplement banks' contactless card issuance activities with a product that the agency can influence and that anyone can buy. This capability provides agencies with the means to support open network-branded fare payment systems that reach all riders.

The prepaid industry is comprised of several types of cards, each of which is capable of supporting one or more segments of riders. Agencies should explore each type to develop a strategy that optimizes their fare media mix by using third party-issued card products. The architecture of bank card-based fare payment systems facilitates this approach.

Transit agencies may be able to achieve a variety of economic benefits from using network-branded payment cards with their systems, but agencies must clearly understand the costs associated with their current closed loop operation (e.g., card costs, security, encoding, issuance, support man-hours, maintenance). Prepaid cards provide the transit merchant the ability to reach the majority of its customers with payment products designed for open payment systems, tailor products to meet specific needs, and do so at a lower cost.

8   Publication Acknowledgements

This report was developed by the Smart Card Alliance Transportation Council to provide an overview of the prepaid card industry and the products available, including network-branded prepaid cards. Publication of this document by the Smart Card Alliance does not imply the endorsement of any of the member organizations of the Alliance.

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- **David deKozan**, Cubic
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- **Mike Kutsch**, Cubic
- **Michael Laezza**, Thales

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- **Burt Wilhelm**, MasterCard Worldwide

About the Smart Card Alliance Transportation Council

The Transportation Council is one of several Smart Card Alliance Technology and Industry Councils, focused groups within the overall structure of the Alliance. These councils have been created to foster increased industry collaboration within a specified industry or market segment and produce tangible results, speeding smart card adoption and industry growth.

The Transportation Council is focused on promoting the adoption of interoperable contactless smart card payment systems for transit and other transportation services. The Council is engaged in projects that support applications of smart card use. The overall goal of the Transportation Council is to help accelerate the deployment of standards-based smart card payment programs within the transportation industry.

The Transportation Council includes participants from across the smart card and transportation industry and is managed by a steering committee that includes a broad spectrum of industry leaders.

Transportation Council participation is open to any Smart Card Alliance member who wishes to contribute to the Council projects. Additional information about the Transportation Council can be found at http://www.smartcardalliance.org/about_alliance/councils_tc.cfm.

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9   Appendix A: Glossary of Terms[20]

Automated teller machine (ATM)

A computerized telecommunications device that provides the clients of a financial institution with access to financial transactions in a public space without the need for a cashier, human clerk or bank teller.

Bank Identification Number (BIN)

The first 6 to 8 digits of the credit, debit or prepaid card number that serves to identify the institution that issued the card to the card holder. The rest of the number is determined by the issuer.

Card association

A network of issuing banks and acquiring banks that process payment cards of a specific brand.

Customer Identification Program

A program intended to enable a bank or financial institution to form a reasonable belief that it knows the true identity of each customer. It must include new account opening procedures that specify the identifying information that will be obtained from each customer. It must also include reasonable and practical risk-based procedures for verifying the identity of each customer.

Closed loop payment cards

A card that is specific to single merchant organization. The authorization process can only be provided by the organization that issued the card and the funds used by the card do not leave the issuing organization.

Contactless payments

Payment transactions that require no physical contact between the consumer payment device and the physical point-of-sale (POS) terminal. In a contactless payment transaction, the consumer holds the contactless card, device or mobile phone in close proximity (less than 2-4 inches) to the merchant POS terminal and the payment account information is communicated wirelessly (via radio frequency (RF)).

Credit card

A card entitling its holder to buy goods and services based on the holder's promise to pay for these goods and services.

Debit card

A plastic card (also known as a check card) that provides an alternative payment method to cash when making purchases. Functionally, it can be called an electronic check, as the funds are withdrawn directly from either the bank account or from the remaining balance on the card.

Gift card

A restricted monetary equivalent that is issued by retailers or banks to be used as an alternative to a non-monetary gift.

Issuer

The organization that issues a card to an individual and maintains the account, provides account servicing, billing, and other required functions for a card program.

Issuing bank

The bank that provides the credit card to the cardholder. The term is often interchanged with "issuer."

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[20] Term definitions came from a variety of sources, including http://en.wikipedia.org.

Load network

The entity that facilitates loading monetary value to a stored value or prepaid card via a network of terminal devices and authorized locations. Card holders provide cash to the load network in exchange for value being added electronically to their card account.

Network-branded prepaid card

A prepaid card that carries a payment brand such as American Express, Discover, MasterCard, or Visa.

Non-reloadable prepaid card

A prepaid payment card that is sold or activated for a specific dollar amount and once that amount has been spent the card is no longer usable.

Open loop payment card

A payment card that operates on interoperable payment networks where the issuer of the card is separate and distinct from the acquirer or merchant who accepts the card for payment for goods and/or services.

Office of Foreign Assets Control (OFAC)

An agency of the United States Department of the Treasury under the auspices of the Under Secretary of the Treasury for Terrorism and Financial Intelligence. OFAC administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign states, organizations, and individuals.

Payment network

(Also known as a payment system) A system (including physical or electronic infrastructure and associated procedures and protocols) used to settle financial transactions in automated teller machine networks, stored-value card networks, credit and debit card networks, bond markets, currency markets, and futures, derivatives, or options markets, or to transfer funds between financial institutions.

Personalization

Refers to the process of assigning a specific identity to a payment card by embossing or otherwise permanently marking the name of the account owner or holder to the face of the card and writing electronic information to the card's magnetic stripe or smart card chip. Personalization is required for all cards that are reloadable.

Prepaid card

A payment card that provides access to a prepaid value, rather than a line of credit. The card is used until the value is gone and the card is discarded or reloaded.

Primary account number

A number that is found on credit cards and bank cards. The number has a certain amount of internal structure and shares a common numbering scheme. Credit card numbers are a special case of ISO/IEC 7812 bank card numbers.

Processor

In the context of this white paper, an organization that provides technology and back office operations services to issuers and program managers for payment card programs. Services may include card issuance, management of a customer information file, facilitating authorization and settlement of payment transactions, billing and statement generation, or some combination thereof.

Program manager

An organization that operates a payment card program on behalf of a sponsor organization. The role of the program manager often includes total responsibility for the program such as cardholder outreach marketing, enrollment, card distribution, customer service, financial transaction processing, error resolution, and all other services necessary for the proper function of the program.

Regulation E

The Electronic Funds Transfer (EFT) Act, also known as Regulation E, was implemented in the U.S. in 1978 to establish the rights and liabilities of consumers as well as the responsibilities of all participants in EFT activities.

Reloadable prepaid card

A prepaid payment card that is capable of being loaded with value multiple times during the life of the card.

Short Message Service (SMS)

A communication service component of the Global System for Mobile Communication (GSM), using standardized communications protocols that allow the exchange of short text messages between mobile phone devices.

Social Security number (SSN)

In the United States, a Social Security number (SSN) is a nine-digit number issued to U.S. citizens, permanent residents, and temporary (working) residents under section 205(c)(2) of the Social Security Act, codified as 42 U.S.C. § 405(c)(2). The number is issued to an individual by the Social Security Administration, an independent agency of the United States government.

Stored value card

A smart card containing one or more purses which can be loaded and reloaded with value and used to make purchases.

Tax Payer Identification Number (TIN)

An identifying number used for tax purposes in the United States. It may be assigned by the Social Security Administration or by the Internal Revenue Service (IRS).

Transit agency

A transit district or transit authority that is a special-purpose district organized as either a corporation chartered by statute or a government agency, created for the purpose of providing public transportation within a specific region.

Transit benefit

A benefit program offered by employers to employees that provides for the use of public transportation through a coordinated program that offers savings to the employee. The benefit takes the form of pre-tax deductions from employee pay to pay for a fixed amount of public transportation services as allowed under the federal tax code.

10 Appendix B: Prepaid Industry Resources

The following are trade associations, trade shows and publications covering the transit industry that are good resources for transit agencies.

10.1 Trade Associations

Network Branded Prepaid Card Association (NBPCA), http://www.nbpca.com

10.2 Trade shows

Prepaid Cards Conference, http://www.prepaidcardsevent.com/Event.aspx?id=269228

ATM, Debit, and Prepaid Card Forum, http://www.sourcemediaconferences.com/ATMDebit07/

Prepaid Card EXPO, http://www.iirusa.com/prepaid/welcome-page.xml

MasterCard and Visa annual prepaid conferences, http://www.mastercard.com, http://www.visa.com

10.3 Publications

American Banker, http://www.americanbanker.com/

ATM & Debit News, http://www.paymentssource.com/atm-debit-news/CardFlash, http://www.cardweb.com/cardflash/

CardLine, http://www.paymentssource.com/cardline/

Cards and Payments, http://www.paymentssource.com/cards-payments/

Corporate & Incentive Travel, http://www.themeetingmagazines.com

Corporate Meetings & Incentives, http://meetingsnet.com/corporatemeetingsincentives/

Digital Transactions, http://www.digitaltransactions.net/

Green Sheet, http://www.greensheet.com/

Integrated Solutions for Retailers, http://www.retailsolutionsonline.com/

Paybefore, http://www.paybefore.com/

Payments Source, http://www.paymentssource.com

Plastic Rap Blog, http://www.bankrate.com/

The Prepaid Press, http://www.prepaid-press.com/

Specialty Retail Report, http://www.specialtyretail.com/

Transaction Trends, http://www.electran.org/

Transaction World Magazine, http://www.transactionworld.net/start.asp

10.4 Reports and White Papers

"Demystifying Prepaid Cards: An Opportunity for the Community Development Banking Institution Sector," National Community Investment Fund, September 2009, http://www.ncif.org/images/uploads/20090921_NCIF_DemystifyingPrePaidCards.pdf

"General-Use Prepaid Cards: The Path to Gaining Mainstream Acceptance," James McGrath, Federal Reserve Bank of Philadelphia, March 2007, http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2007/D2007MarchGeneralUsePrepaidCards.pdf

"Prepaid Cards: An Important Innovation in Financial Services," Julia S. Cheney, Federal Reserve Bank of Philadelphia, and Sherrie L. W. Rhine, Federal Reserve Bank of New York, July 2006, http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2006/D2006JulyPrepaidCardsACCIcover.pdf

"Prepaid Cards; Vulnerable to Money Laundering," Stanley Sienkiewicz, Federal Reserve Bank of Philadelphia, February 2007, http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2007/D2007FebPrepaidCardsandMoneyLaundering.pdf

"The Race Is on in Prepaid," Mark Beresford and Steve Karp, Edgar Dunn & Company white paper, September 2007, http://www.edgardunn.com/uploads/100030_english/100232.pdf

"Serving Unbanked Consumers in the Transit Industry with Prepaid Cards," Smart Card Alliance Transportation Council white paper, June 2008

11 Appendix C: Bank Regulations for Accepting Open Loop Prepaid Cards

This appendix is intended to provide an overview of the several of the bank regulations that are in place governing open loop prepaid cards. The Smart Card Alliance and its members do not intend that this section be used as legal advice. Transit agencies should consult their legal counsel for guidance on applicable regulatory compliance requirements.

Unlike traditional proprietary stored value transit cards, which can only be used to pay for public transportation, open loop prepaid cards are issued by a bank and can be used for multiple purposes. Open loop cards can be used to make purchases at retail establishments, pay bills on line, and even withdraw money from an ATM. They are easily smuggled across borders and can be traded, similar to cash.

Because open loop cards are so similar to cash, numerous laws apply to the banks issuing them.

11.1 Title 18

Purchasing an open loop card is potentially a relatively simple way to launder money within the United States. Title 18 of the United States Code (18 U.S.C.), Sections 1956, 1957, and 1960 makes money laundering a crime, punishable by imprisonment for up to 20 years and fines of up to twice the amount of the transactions.

11.2 USA PATRIOT Act

The USA PATRIOT Act,[21] passed in the wake of the September 11 terrorist attacks, provides the government with tools to combat global terrorism, some of which govern how banks behave. The Act contains the following provisions:

- Requires all financial institutions covered by the Bank Secrecy Act (BSA) to establish and maintain written anti-money-laundering programs

- Requires financial institutions to obtain minimum information from and verify the identity of all new customers under a written Customer Information Program (CIP)

- Requires enhanced due diligence on correspondent accounts maintained for foreign financial institutions and private banking accounts maintained by or on behalf of non-U.S. persons

- Prohibits certain dealings with foreign shell banks

- Expands the types of financial institutions that are required to file suspicious activity reports

- Increases the government's ability to obtain information from financial institutions relating to suspected money laundering and terrorist financing activities

11.3 Bank Secrecy Act

The primary U.S. law governing the anti-money-laundering obligations of financial institutions is the BSA, 31 U.S.C., Sections 5311-5355. As originally enacted in 1970, the BSA imposed a number of record-keeping and reporting obligations on banks and other financial institutions in connection with cash transactions.

A broad array of financial institutions are subject to the BSA, including banks, trust companies, securities brokers–securities dealers, mutual funds, money services businesses (MSBs), casinos, operators of credit card systems, and others, including agents of certain of these entities.

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[21] USA PATRIOT is an acronym for Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism.

As amended by the USA PATRIOT Act, the BSA imposes five basic requirements on financial institutions including any MSBs subject to its provisions.

1. Financial institutions and other businesses must obtain certain information and file a currency transaction report (CTR) for all cash-in or cash-out transactions that involve more than $10,000, including multiple cash transactions by one person in one day that total over $10,000.

2. Financial institutions must identify and obtain certain information from any customer who purchases $3,000-$10,000 worth of money instruments, using cash, in any one day, or who sends someone else funds of $3,000 or more, again using cash. (Note that this requirement does not currently apply to the sale of prepaid cards by MSBs.)

3. Financial institutions must file a suspicious activity report (SAR) with the government that records suspicious transactions or patterns of transactions. A suspicious transaction is one that the financial institution knows, suspects, or has reason to suspect involves criminal activity, is designed to evade the requirements of the BSA, or appears to serve no lawful or legitimate business purpose. (Note that MSBs are not currently required to file SARs in connection with the sale or redemption of prepaid cards.)

4. Certain financial institutions must create CIPs. Pursuant to the requirements of these programs, banks must obtain identification information from all customers opening new accounts (which may include certain types of open loop prepaid card accounts) and verify the customer's identity so that the bank has a reasonable basis for believing that it knows the true identity of the customer.

5. All financial institutions, including MSBs (except those exempted by the Treasury Department) must establish and maintain written risk-based anti-money-laundering programs.