

VIEWPOINT

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2020 OUTLOOK: PREPAID

Unpredictability in the U.S. economic and political environment will likely cause segment shift in prepaid.

The April 2019 changes in the “Prepaid Rules” by the Consumer Financial Protection Bureau, which require prepaid general purpose reloadable (GPR) cards to have the same protections as debit cards, have resulted in modifications to prepaid program product offerings in the United States. Several other factors will affect prepaid in the coming year. Challenger banks that are currently online-only present new competition. Technological advances and economic and political factors will also influence the success of prepaid in 2020.

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What to Anticipate in Prepaid for the U.S. in 2020

Prepaid debit cards are a financial tool used to store and move money in a number of segments within the U.S. economy. Most consumers recognize prepaid debit cards as “gift cards” or as a “reloadable” form of payment known as general purpose reloadable (GPR) prepaid cards or as payroll cards. Factors that always influence the open and closed loop prepaid debit card markets in the United States are regulations and laws and economic conditions. In 2019, prepaid program managers have been adjusting their product offerings to comply with the Consumer Financial Protection Bureau’s changes to prepaid regulations. Prepaid debit card platforms are at the forefront of innovation, but uncertainty about U.S. governmental policies could cause segment shifts.

First, a Quick Look Back at 2019

In last year’s Mercator Advisory Group outlook for prepaid cards, [2019 Outlook: Prepaid](#), released on November 7, 2018, we made the predictions listed at left in the table below. The actual outcomes are listed on the right.

Mercator Predictions for 2019	Actual Outcomes
<p>A fintech will apply for either a Special Purpose National Bank (SPNB) charter or an industrial bank charter, which will be litigated in 2019–2020.</p>	<p>At least two charters have been applied for: Varo Money applied for a Special Purpose National Bank charter, which was preliminarily approved in late 2018 and is expected to attain full approval in 2020. Square and Rakuten have both applied for industrial bank charters. Other challenger banks, including Chime, Monzo, Moven, and N26, are operating using a partner U.S. sponsor bank. Litigation has begun, with various state regulators and portions of the banking industry fighting back to prevent charter banks from being approved to operate in the financial services space with unequal regulations between competitors. The Office of the Comptroller of the Currency is appealing a New York federal judge’s October 2019 decision denying the OCC’s authority (under the National Bank Act decision to grant SPNB charters (“fintech charters”) to non-depository institutions</p>
<p>Machine learning, a form of artificial intelligence (AI), and blockchain will be used to streamline processes.</p>	<p>Significant improvement has occurred in many processes through AI. Verification in compliance with Know your Customer (KYC) rules is increasingly</p>

	performed through machine learning, as are most fraud management algorithms. Blockchain is still emerging and has yet to find widespread acceptance.
Additional product offerings using cryptocurrency will become available.	Cryptocurrency gift cards have emerged, offered by Bidali. They can be purchased using Bitcoin, Ethereum, Litecoin, and many more currencies from wallets like MetaMask, Evercoin, Enjin, Mycelium, MyEtherWallet, Jaxx, Trust Wallet, imToken, Coinbase Wallet, and others.
New fraud risks will arise from new technology.	Fraud has arisen from bots, mobile wallets, and person-to-person (P2P) payments, especially as it relates to personally identifiable information (PII).
A good economy and low unemployment will reduce funds paid in government prepaid segments like state unemployment, Temporary Assistance for Needy Families (TANF), and Nutritional Assistance.	As expected, the volume of government payments in both TANF and Nutritional Assistance prepaid segments has fallen, TANF having the most significant change with a decrease of -64% from 2017 to 2018, to \$2.3 billion and its project to stay there in 2019 unless the economy goes into a recession.
Consumer Incentives and Events & Meetings will maintain existing load volumes	Volume on Incentives cards stayed the course, growing from \$14.0 billion to \$14.2 billion, as did volume in the Events & Meetings segment, which grew from \$13.5 billion to \$13.8 in 2018 based on our most recent benchmark.
Growth in Health Savings Accounts (HSAs)	In 2018, Health Savings Accounts loads grew at 110.31%, to \$76.2 billion, reflecting U.S. employers' continued adoption of high-deductible healthcare programs.
Commercial/Business Prepaid Card growth	Growth continued particularly in the Consumer Incentives and Payroll prepaid card segments.

Major Issues

New Prepaid Regulations

On April 1, 2019, the regulations of the “Prepaid Rule” by the Consumer Financial Protection Bureau went into effect. The regulations contained many changes that prepaid program managers and issuers in the United States had to abide by, most notably the short-form and long-form disclosures that make it much easier for consumers to compare products in order to find solutions that best suit their needs. Further consumer protections were added to assure that prepaid debit card users have the same governmental protection that checking account holders enjoy: the right to dispute transactions and a set time frame to investigate and resolve issues. Overdraft protection on general purpose reloadable cards has been all but eliminated through these regulations. Providers are sunsetting existing products and changing their product lines to accommodate the rules yet maintain their revenue stream.

The Prepaid Rule broadened the definition of prepaid debit card such that mobile wallets and person-to-person payment providers like Venmo fall under the regulations of the CFPB. The line between prepaid debit cards and debit cards that are attached to a checking account is increasingly blurred from a regulatory standpoint and will be complicated further by banking as a service (BaaS) solutions entering the market.

Litigation of Nonbank Charter

In mid-2018, the Office of the Comptroller of the Currency (OCC) determined that nonbanks should be allowed to obtain a bank charter, either a “Special Purpose National Bank” charter or an industrial bank charter.ⁱ The stated intention of the OCC is to bring nonbanks, in particular financial technology providers (fintechs), under the same sort of regulatory supervision that is imposed on federally chartered national banks and state-chartered banks while preserving their ability to innovate. An industrial bank is a state-chartered bank whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC) but which is exempt from the Bank Holding Company Act, which means that industrial charter banks are not subject to many of the laws and requirements governing community banks. There have been applications and even tentative approval for a de novo National Bank Charter (to Varo Money)ⁱⁱ that is different from an OCC charter. This process is being disputed not only by banks and regulators but in court. Still, we believe a fintech charter of some type will most likely be issued in 2021. We foresee this charter, if it is upheld, being a significant path to market for legacy prepaid operators who are expanding into banking as a service, discussed below.

Banking as a Service (BaaS) and Challenger Banks

Banking as a service (BaaS) is the process by which challenger banks such as Chime Bank, Monzo, Moven, and N26 are endeavoring to disrupt both the prepaid debit card (general purpose reloadable) market and the checking account market at chartered financial institutions, examples being Green Dot, Sutton Bank, and Bancorp Bank. This is because challenger banks (new participants trying to gain a foothold in the United States’ financial service industry in a way that is different from the status quo) are targeting not only the GPR market, which is typically the unbanked and underbanked, but also consumers who are borderline financially underserved or seeking “second

chance” accounts. Many of the incumbent players are from outside the United States and are using this service/process to enter the U.S. market. Expect to see a number of market entrants in 2020. The question is: Will they survive?

U.S. Economic Outlook Is ...

As stated earlier in this *2020 Outlook: Prepaid*, economic conditions affect prepaid cards because prepaid usage is closely tied to the rise and fall of the economy. Here are a few of the many economic predictions for 2020 to consider:

- GDP is expected to decline, falling from 2.0–2.4% in 2019 to between 1.8% and 2.0% in 2020.ⁱⁱⁱ
- Ongoing trade negotiations are a wild card.
- Ongoing tariffs are likely to be a drag on the economy at least in the short term and especially if they are expanded. They have already contributed to the volatility we are seeing in the stock market.
- Unemployment will stay low, around 3.5% with slight increases.^{iv}
- Consumer confidence is currently 92% but is expected to decrease in the coming year to 85%.
- Inflation is predicted to stabilize at 2.00%.^v
- The Federal Reserve’s fed funds rates will likely decrease from 2.25–2.00% to 1.75–2.0% in 2020.^{vi}
- Corporations will hold \$9.0 trillion in debt in 2020, up from 6.3 trillion in debt in 2019.^{vii}
- The federal deficit for fiscal year 2020 will be near \$1 trillion, up from \$960 billion in 2019.^{viii}

It was expected to be a difficult balancing act in 2019 to keep the economy growing and keep inflation under control while simultaneously paying down the federal deficit. However, inflation remains in check, the economy is growing, and although it was expected to be reduced, the U.S. budget deficit has in fact risen. If the economy heads toward a recession, which is predicted by some for late 2019–2020, we will see unemployment and nutritional assistance reverse trend. Actions by the Federal Reserve to raise interest rates to a normal range after keeping them as low as possible for several years will raise the cost to corporations to manage and pay off debt load in 2020, causing a possible decrease in the Incentives and Meetings & Events segments of prepaid cards. As of the date of this writing, the Federal Reserve has raised rates in 2019 but then lowered them.

If, however, low unemployment continues in the United States, we expect that the government segments of the U.S. prepaid cards market, including the TANF and Nutritional Assistance segments, will continue to decrease and the Incentives and Events & Meetings segments will remain at the current level or grow if corporations continue to have discretionary spend.

Predictions for 2020: The Forecast Is Mostly Sunny

- **The Transit segment** of prepaid will see a decrease due to the implementation of contactless cards in the U.S. market, which will displace the current systems over time. As an example, New York's Metropolitan Transportation Authority (NY MTA) is phasing out its own MetroCard and will offer a new card known as OMNY.^{ix} This will not be the only option available to pay fares. Contactless debit and credit cards as well as mobile payment by smartphone will all be options.
- Expect to see growth in previously attempted segments, namely **gambling and lottery gift cards**, as well as new growth in the healthcare wellness sector driven by large insurance agencies, Medicare, and Medicaid.
- **Cryptocurrency is a focus.** Shift, a Visa debit card service that was partnered with Metropolitan Commercial Bank and based in the United States to enable Shift Card users to spend cryptocurrencies held in Coinbase, ceased operation in April 2019. That left Shift customers in 46 states with only one reliable option for spending cryptocurrency from a financial institution in the United States—the BitPay Visa debit card. Since then Metropolitan Commercial Bank has introduced another cryptocurrency card, BlockCard™, a physical debit card powered by Ternio.
- **Person-to-person payments (P2P)**, also referred to as peer-to-peer payments, are now officially considered a prepaid product offering if the application (card, mobile phone, or other device) stores money or value on it. In a P2P network, the "peers" are computer systems connected to each other via the internet. Files are shared directly between systems on the network without the need of a central server. We can expect additional players to join the established players in this segment, Venmo, Square Cash, and Dwolla.
- **The open loop FSA/HSA Tax Deferred Programs segment will also maintain growth** as it continues to benefit from high-deductible health care plans paired with Health Savings Accounts.
- **Banking as a service (BaaS)** is offered by fully chartered banks to nonbanks seeking to enter the financial services market. In the BaaS business model, a fully chartered bank sells access to its banking platform via application programming interfaces (APIs), thereby extending the bank footprint for deposit gathering through "challenger banks." There are a number of factors to consider here: One is that the OCC's authority to grant Special Purpose National Bank charters is under litigation. Others are consumers' acceptance of banking at digital-only banks and the ways in which the financial services industry may be changed by challenger banks that are really brands (Walmart, Square) opening up physical locations. This will be a fight for consumers between legacy financial institutions and fintechs. It will force the creation of new regulations to preserve the safety and soundness of the financial system.
- **Finally, we expect to see a continued prepaid push in the business segment**, not only as a replacement for small business checking accounts but also for streamlining expenses and accounts payable ways to facilitate disbursements. Positive outcomes similar to what has happened in the prepaid world for consumers can be expected in business prepaid/form factors within the next five years.

Endnotes

- ⁱ <https://www.occ.gov/topics/supervision-and-examination/responsible-innovation/comments/pub-special-purpose-nat-bank-charters-fintech.pdf>
- ⁱⁱ <https://finance.yahoo.com/news/fintech-leader-varo-money-extends-130005464.html>
- ⁱⁱⁱ Kiplinger, <https://www.kiplinger.com/article/business/T019-C000-S010-gdp-growth-rate-and-forecast.html>
- ^{iv} <https://tradingeconomics.com/united-states/forecast>
- ^v <https://knoema.com/kyawad/us-inflation-forecast-2019-2024-and-up-to-2060-data-and-charts>
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