



Update

NEWSLETTER

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2011 Discussion Papers

A newsletter published by the Payment Cards Center, providing meaningful insights into developments in consumer credit and payments

From the Director

Bob Hunt, Vice President & Director

As you will see in this edition of *Update*, 2011 has been an extremely busy year and a year of change for the Payment Cards Center. One of our most valued staff members, Gayle Griffith, has retired, but not before a new member of the team, Stephen Pipito, was hired and acclimated to the challenging job of supporting our efforts. Also, we would like to wish Philip Keitel success in his new role as part of the Bank's Legal Department. His legal training will be missed in the PCC. At the same time, we are pleased to announce the addition of a new industry specialist, Dubravka Ritter,¹ to the center's staff. After receiving an M.A. in economics from the University of Toronto, Dubravka spent four years with Charles River Associates before joining us in May. We continue to recruit additional industry specialists, so please spread the word.

The center has published five new discussion papers since the last edition of *Update*. These papers are summarized later, but the range of topics covered is worth pointing out: the application of payment cards to commercial payments and small business credit; a review of the many ways in which financially distressed consumers can renegotiate their unsecured debts and the policy issues these options raise; the ongoing evolution toward acceptance of general-purpose payment cards for travel on the nation's transit systems; a summary of last year's conference on



Bob Hunt

¹ Dubravka's web page can be found at: <http://www.philadelphiafed.org/payment-cards-center/specialists/ritter/>.

the development and regulation of the market for prepaid cards; and an examination of insolvency risk in the prepaid card market and how those risks are mitigated.

In addition to the work by the center's staff, several other departments at the Philadelphia Fed are engaged in research on the markets for consumer credit and payments. Many of these studies appear in the Research Department's Working Paper series. In the first nine months of this year, 12 new articles on these topics have been added to the Working Paper series.² Two of those papers are co-written by PCC visiting scholars. Mike Staten, together with John Barron, has written a paper examining whether the means of conducting credit counseling (face-to-face, over the phone, or via the Internet) affects consumers' credit scores a year or more later. Jon Zinman, together with Victor Stango, has written a paper that investigates whether consumers' propensity to incur overdrafts on their checking accounts is influenced by limited attention. Space precludes me from describing all the interesting papers being published at the Philadelphia Fed. But an excellent example is a Working Paper, "Rising Indebtedness and Temptation: A Welfare Analysis," by Makoto Nakajima. In this paper, Makoto applies calibration techniques commonly used in macroeconomics to examine the consequences of changes in lending markets when a portion of consumers suffer from self-control problems.

In addition to the Working Paper series, Marvin Smith of our Community Development Studies and Education Department, together with Susan Wachter of the Wharton School, published an edited volume of articles under the title "The American Mortgage System: Crisis and Reform."³

This year has also been a busy one for PCC programming. In July, we hosted a conference on the various ways in which state and federal governments interact with the payment card system. This event, organized by Susan Herbst-

Murphy, is described later in the new Center Stage column of *Update*. In September, we held our sixth biennial research conference on Recent Developments in Consumer Credit and Payments.⁴ This event was co-organized with Ronel Elul⁵ and Mitchell Berlin⁶ of our Research Department and featured seven of the best recent academic papers on these topics. These papers examined questions such as:

- Can formal models of payment choice be used to assess how consumers will respond to a variety of regulatory interventions?
- Are consumers who've had some smudges on their credit record systematically riskier than other consumers? If so, by how much?
- Do unanticipated income tax rebates temporarily increase the bankruptcy filing rate because the funds are used to pay filing costs?
- How long must consumers who file for bankruptcy wait before being offered a new credit card and what terms will they be offered?
- Does negative home equity interfere with labor markets because some consumers are unable to move to new jobs?
- Is there a feedback effect between liquidity in mortgage funding markets and home prices?
- Does adjusting certain underwriting or collection features of mortgages change mortgage default rates and the homeownership rate?

In addition, we've hosted two workshops on topics related to prepaid cards. The first examined how the risk of insolvency is managed in open-loop prepaid card programs (the sum-

² Working Papers are available at: <http://www.philadelphiafed.org/research-and-data/publications/working-papers/>.

³ This publication is available for purchase at: <http://www.upenn.edu/upennpress/book/14884.html>.

⁴ The conference agenda with links to papers and presentations can be found at: <http://www.philadelphiafed.org/research-and-data/events/2011/consumer-credit-and-payments/>.

⁵ Visit Ronel Elul's web page at: <http://www.philadelphiafed.org/research-and-data/economists/elul/>.

⁶ Visit Mitchell Berlin's web page at: <http://www.philadelphiafed.org/research-and-data/economists/berlin/>.

mary of this workshop is described later in this issue of *Update*). The second examined the trend toward adoption of general-purpose payment cards by transit agencies, as seen through the experience of the Ready Credit Corporation, a provider of transit-based and general-purpose open-loop prepaid cards. A summary of that workshop is in process.

In addition to organizing our own events, PCC staff have been busy participating in workshops and conferences sponsored by the industry, universities, and our partners in the Federal Reserve System. You may have met me or one of the industry specialists at any one of 21 events in 2011. In all, PCC staff have made more than 14 presentations in the first nine months of this year. This outreach and interaction with colleagues is a priority for the center because it is an important way for us to keep abreast of rapidly changing developments in these markets.

Finally, I would be remiss if I did not point out that this has also been an active year for regulatory developments affecting the markets for consumer credit and payments. The year 2011 marked the birth of the Consumer Financial Protection Bureau and many other changes introduced by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203). One of the most notable regulations established under this act places limits on interchange fees received by large bank debit card issuers (with assets of \$10 billion or more) and introduces a number of other changes that will influence how debit card transactions are routed over payment networks. The effects of these and many other recent regulations are likely topics of future research at the Payment Cards Center.



CENTER NEWS



Steve Pipito



Dubravka Ritter

In May, the center welcomed Dubravka Ritter as an industry specialist. Before joining the Bank, Ritter spent four years as an economist at the consulting firm Charles River Associates. While there, she performed fair-lending statistical and econometric analysis as part of regulatory compliance and risk management support for financial institutions with mortgage, payment card, auto loan, and other portfolios. She also conducted econometric analysis in support of litigation alleging antitrust violations and patent infringement, including market definition, demand analysis, and damages estimation. Her research interests include the economics of discrimination

and equal access to credit, credit and payments markets for underserved consumers, and consumer payment choice. Ritter holds an M.A. degree in economics from the University of Toronto and a B.A. degree in economics, magna cum laude, from Wellesley College.

In July, the center bid farewell to its manager, Gayle Griffith, who retired from the Federal Reserve Bank of Philadelphia after 10 years. In her place, we hired Stephen Pipito as department coordinator. Pipito has been with the Philadelphia Fed for nearly 14 years, during which time he worked in the Bank's Supervision, Regulation and Credit Department. Prior to coming to the Philadelphia Fed, he was a commercial lender for First Union and Bank of America and also worked for General Electric. Pipito has an MBA from Widener University.

Finally, in October Industry Specialist Philip Keitel will be leaving the center to join the Philadelphia Fed's Legal Department. Keitel has been with the center for four years. In that time he has produced eight PCC publications, organized eight workshops and conferences, and made at least 15 presentations on the center's behalf. He has been an important contributor to the center's success as well as an excellent colleague. We are sad that his time with us is ending, but we are also excited for him as he begins the next stage of his career in the Federal Reserve System.

CENTER STAGE

Government Use of the Payment Card System: Issuance, Acceptance, and Regulation

by Susan Herbst-Murphy, Industry Specialist

If you have ever used your credit or debit card to buy stamps at the post office, your purchase was part of the \$9 billion in annual payment card volume to federal public-sector entities that operate as card-accepting merchants. Acceptance is just one way state and federal agencies use the payment card system in carrying out their missions. The General Services Administration manages \$30 billion in annual spending through its SmartPay program, making the GSA the world's largest commercial card client. In addition, a majority of states have adopted prepaid cards so that disbursements of unemployment, child support, and Temporary Assistance to Needy Families can be made electronically to individuals without bank deposit accounts, generating cost savings to the states and expediting the availability of funds to recipients.

Recognizing the significant use of the payment card system by state and federal agencies, the Payment Cards Center hosted a conference, "Government Use of the Payment Card System: Issuance, Acceptance, and Regulation," on July 11 and 12, 2011. Distinguished panelists representing industry networks, issuers, and acquirers; state and federal government agencies; consumer advocacy groups; and academia assembled to discuss how the public sector is leveraging the infrastructure of the payment card system to make purchases, receive payments, and distribute funds.

In his opening remarks to the conference, the center's director, Bob Hunt, observed that the payment card system exhibits characteristics of a general-purpose technology, a broadly adopted innovation with the potential to transform consumer and business activity. As the conference progressed, many of the points shared by the speakers substantiated Hunt's assertion. Conferees learned that the partnerships between government and the card industry have cultivated innovative applications, built on the payment card infrastructure, that have subsequently been expanded to other commercial and consumer usage. In addition to cost savings, the public sector has reaped additional benefits from the card system through improved fraud control, expansion into virtual channels, enhanced management reporting, and data-enabled strategic sourcing. Panelist David Shea, director of the Office of Charge Card Management at the GSA, likened the payment card system to Lego bricks, with all the components available to be assembled and configured for a variety of purposes.

Along with the benefits, there are also areas of concern related to public-sector card programs. Consumer advocates warned of the potential for shifting the costs of distributing benefits through prepaid cards from the government to the beneficiaries through card fees. There are also challenges involved in advancing the previously unbanked along the learning curve once they have been provided with a prepaid card. Panelists also noted that the government itself, in its regulatory capacity, can threaten the viability of some of these card programs when regulations are poorly designed.

A conference summary is forthcoming.*

The conference concluded with a capstone panel composed of three eminent speakers: on the left, Professor Michael Barr, University of Michigan Law School; Professor Ronald Mann, Columbia Law School; and David Evans, far right, Chairman, Global Economics Group. Bob Hunt, second from right, moderated the panel.



* The conference agenda, including presentations from a number of the panelists, is available at: <http://www.philadelphiafed.org/payment-cards-center/events/>.

Visiting Scholars

Payment Cards Center visiting scholars are invited to visit the Reserve Bank on a regular basis to meet with center staff and researchers in the Bank's Research Department. Scholars may work independently on payment cards-related research or collaborate with the center's analysts and Research Department economists to present papers and participate in the center's activities. In this edition of *Update*, we feature abstracts from working papers published by two of the center's scholars during 2011.

**Working Paper 11-17:
LIMITED AND VARYING CONSUMER ATTENTION: EVIDENCE FROM SHOCKS TO THE SALIENCE OF BANK OVERDRAFT FEES**

Jonathan Zinman, Dartmouth College
(with Victor Stango, University of California, Davis)
April 2011

Abstract: The authors explore the dynamics of limited attention in the \$35 billion market for checking overdrafts, using survey content as shocks to the salience of overdraft fees. Conditional on selection into surveys, individuals who face overdraft-related questions are less likely to incur a fee in the survey month. Taking multiple overdraft surveys builds a "stock" of attention that reduces overdrafts for up to two years. The effects are significant among consum-

ers with lower education and financial literacy. Consumers avoid overdrafts not by increasing balances but by making fewer debit transactions and cancelling automatic recurring withdrawals. The results raise new questions about consumer financial protection policy.

**Working Paper 11-11:
IS TECHNOLOGY-ENHANCED CREDIT COUNSELING AS EFFECTIVE AS IN-PERSON DELIVERY?**

Michael Staten, University of Arizona
(with John Barron, Purdue University)
February 2011

Abstract: This paper compares outcomes for borrowers who received face-to-face credit counseling with similarly situated consumers who opted for counseling via the telephone or Internet. Counseling outcomes are measured using consumer credit report attributes one or more years following the original counseling. The primary analysis uses data from a sample of 26,000 consumers who received credit counseling either in-person or via telephone during 2003. A second sample of 12,000 clients counseled in 2005 and 2006 was provided by one of the agencies to examine Internet delivery. Technology-assisted delivery was found to generate outcomes no worse — and at some margins better — than face-to-face delivery of counseling services.

¹ You can find a complete list of the Payment Cards Center's visiting scholars, with links to brief biographies, at: <http://www.philadelphiafed.org/payment-cards-center/visiting-scholars/>.

² The papers featured here are available at: <http://www.philadelphiafed.org/payment-cards-center/publications/working-papers/>.

Website UPDATE

With the release of the 2010 Federal Reserve Payments Study this year, the consumer statistics pages on the Payment Cards Center's website have undergone some significant updates. One new section in the consumer payments snapshot,* Prepaid, reflects the additional prepaid research sponsored by the Federal Reserve for the 2010 payments study. In addition, a new feature allows visitors to the consumer statistics pages to download an Excel spreadsheet with historical data for selected data series. The consumer statistics pages will continue to be updated quarterly in order to offer visitors the most current conditions in consumer credit and payment markets.

* The consumer statistics pages are available at: <http://www.philadelphiafed.org/payment-cards-center/tools-for-researchers/consumer-statistics/>.

PCC Workshops

During the course of the year, the Payment Cards Center's industry specialists organize a number of workshops around topics in consumer credit and payments. These internal workshops are most often led by invited presenters and follow an informal discussion format. In some cases, the content discussed will lead to written discussion papers or future collaborations with the speaker, while in other instances the workshop will simply serve to educate the audience. Since its inception in 2000, the workshop series has grown to be a focal point for the center's research agenda. Highlighted in this edition of *Update* are some of the workshops hosted during 2011.¹

March 2011

What Are the Implications for Consumers and Banks When an Organization in the Prepaid Value Chain Goes Bankrupt?²

Jeremy Kuiper, Managing Director, Payment Solutions Group, Bancorp Bank

Terry Maher, Partner, Baird Holm LLP

Ted Martinez, Leader, North America Credit Settlement Risk Team, Visa

Kirsten Trusko, President and Executive Director, Network Branded Prepaid Card Association

Overview: The value chain for network-branded prepaid cards involves more parties than those commonly present in credit- or debit-card-issuing arrangements: the merchant acquirer, processors, a payment network, and a card-issuing bank. These additional participants may include a program manager, a distributor, and a seller. Since a number of independent businesses make up the chain, each one, as well as cardholding consumers, could be exposed to losses resulting from the insolvency of another party in the value chain. This risk is both real and manageable, as illustrated by two recent incidents involving network-branded prepaid cards: the failures of Silverton Bank, N.A., and Springbok Services, Inc. On March 18, 2011 the Payment Cards Center hosted a workshop that examined the implications of insolvency in the network-branded prepaid-card value chain, to review how market participants have responded to this risk, and to discuss controls the industry has developed to mitigate and address these challenges.

August 2011

Adoption and Use of Open-Loop Prepaid Cards for Transit Applications

Tim Walsh, CEO, Ready Credit Corporation

Overview: Transit agencies around the country are redesigning their transit fare payment systems to accept payment cards (credit, debit, and prepaid cards) at turnstiles, fare boxes, and points of entry or exit. A number of transit agencies will soon join the majority of U.S. merchants (87 percent) who accept payment cards at points of sale. In the last few years, the Payment Cards Center has hosted several workshops on the electronification of transit fare payment systems. The first³ focused on the perspective of a large transit agency, and the second⁴ presented the views of a large issuer of bank cards serving this market.

Our third workshop in this series provided the perspective of a nonbank company that supplies transit agencies with automated prepaid card vending systems and the ability to instantly dispense bank-issued prepaid cards to consumers. This workshop explored the business model employed by the company — Ready Credit Corporation. It also reviewed a number of coordination and communication issues that arise from the complex value chain associated with network-branded prepaid cards. Finally, the workshop examined what Ready Credit has learned about how consumers think about prepaid cards, how they obtain these cards, and how they use them in practice.

¹ For a complete list of workshops, visit the Payment Cards Center Events page at: <http://www.philadelphiafed.org/payment-cards-center/events/>.

² The discussion paper related to this workshop is featured in this edition of *Update* and can also be found at <http://www.philadelphiafed.org/payment-cards-center/publications/>.

³ The discussion paper related to this workshop can be found at: <http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2009/D2009AprilSEPTA.pdf>.

⁴ The discussion paper related to this workshop can be found at: <http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2011/D-2011-April-Chase-Transit.pdf>.

2011 Discussion Papers

Our industry specialists have been busy writing for much of 2011. Here we provide abstracts to the five papers published by the center this year.*

Insolvency Risk in the Network-Branded Prepaid Card Value Chain

Philip Keitel

Published: September 2011

Summary: The result of a March 2011 workshop, this paper summarizes the information presented, including the ways in which consumers and businesses are protected from the insolvency of the issuing bank or a key participant. In addition, this paper highlights practices that have been developed in the industry to mitigate this risk.

Meeting the Demand for Debt Relief

Stephanie Wilshusen

Published: August 2011

Summary: Each year, millions of financially distressed consumers in the U.S. face a difficult choice among the debt relief options available to them. This paper describes the options available to borrowers who seek assistance in managing their debts and discusses the information and incentive problems associated with these options. It also reviews the trends that contributed to the breakdown of the repayment framework and the responses to these trends. Among the responses is a reconsideration of the regulatory structure of the debt relief industry. The paper concludes with a discussion of the importance for debt relief providers and policy-makers to evaluate the efficacy of workout options and to develop a deeper understanding of how consumers make decisions about incurring and repaying debt. Wilshusen presented this paper at the Boulder Summer Conference on Consumer Financial Decision Making hosted by the Leeds School of Business at the University of Colorado-Boulder and at the World of Credit and Counseling Symposium, which was held at Magdalene College, Cambridge University.

Federal Regulation of the Prepaid Card Industry: Costs, Benefits, and Changing Industry Dynamics

Philip Keitel

Published: June 2011

Summary: On April 8-9, 2010, the Payment Cards Center hosted a conference that brought together leaders in the prepaid card industry, regulators, consumer groups, law enforcement agents, and industry researchers to discuss the economics of prepaid cards and the benefits and costs of their regulation from the standpoint of several different product categories. In particular, the conference examined ways in which prepaid card products can differ, how the industry has developed over time, ongoing industry dynamics, ways in which the usefulness of prepaid products to crimi-

nals might be limited, whether consumers who use prepaid cards are adequately protected, and the challenges facing regulators. This paper summarizes the highlights from the presentations given at the conference and the discussions that ensued.

The Electronification of Transit Fare Payments: Examining the Case for Partnerships Between Payments Firms and Transit Agencies

Philip Keitel

Published: April 2011

Summary: Several of the nation's largest payment-card-issuing banks are working with public transit agencies to enable consumers to pay fares by using payment cards, and more such partnerships may be on the horizon. On April 23, 2009, the Payment Cards Center of the Federal Reserve Bank of Philadelphia hosted a workshop to discuss the potential adoption of electronic payments by transit agencies from the perspectives of several subject matter experts from J.P. Morgan Chase & Co. James Lock, vice president and senior advisor, Treasury Services Global Advisory Solutions group; Jameson Troutman, strategy manager with Chase Card Services; and Krista Gallagher, from Chase's retail banking team, attended the workshop. This paper looks at several electronic transit-fare payment models and the potential opportunities these models present to transit agencies and payments firms, such as the opportunity for transit agencies to reduce costs and to operate a more efficient payments infrastructure or the opportunity for the payments industry to increase consumers' use of contactless payment technology. This paper also identifies significant obstacles to widespread adoption of systems that allow consumers to use their credit, debit, or prepaid cards to pay fares directly.

Getting Down to Business:

Commercial Cards in Business-To-Business Payments

Susan Herbst-Murphy

Published: March 2011

Summary: Providing efficiency and cost-savings over paper payments (cash and checks), commercial payment cards are among the fastest growing card segments in recent years. Today, they account for nearly one in every five dollars spent using general-purpose payment cards. And since business and government payments are three times larger than consumer transactions, there is ample room for future growth. Adoption by government and small business has been especially noteworthy. Adoption among large companies, which account for half of commercial expenditures, has been more modest. This paper provides an overview of the commercial card product set, its successes and challenges, and the adaptations that have been made to meet market demands and expectations.

* All papers are available on the center's website at: <http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/>.

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The mission of the Payment Cards Center is to provide meaningful insights into developments in consumer credit and payments that are of interest not only to the Federal Reserve System but also to the industry, other businesses, academia, policymakers, and the public at large. The center carries out its mission through an agenda of research and analysis as well as forums and conferences that encourage dialogue incorporating industry, academic, and public-sector perspectives.