

## **So Tell Me What You Really Think: Payroll Cards from the Consumer's Perspective**

This paper addresses information gleaned from focus groups with consumers who receive their pay on payroll cards and how this information applies to the decisions facing the policy makers. In addition to the focus group comments, a brief survey was administered to participants. The data, *while not representative of payroll card users in general*, provide some insights into how consumers use their payroll cards as part of their cash-flow management practices.

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### **What are Payroll Cards?**

As businesses move to lower their costs, they are increasingly looking within their business operations to lower operating costs and cut waste. One area where these cuts are being made is their payroll operations, and one avenue for this is using electronic funds transfers (EFT) for paying their employees. This is most often done through direct deposit into an employee's checking or savings accounts. However, many unbanked workers cannot receive their pay through direct deposit. As an alternative, payroll cards allow workers to receive their paychecks through EFT without requiring them to have a formal bank account.<sup>3</sup> An estimated two million payroll cards are currently in use. Workers can use these cards to access their pay at an ATM or at point of sale (POS) transactions to make purchases and to receive cash back. Some systems also allow electronic bill payment.

Although they may look like a traditional transaction account, payroll cards differ in important ways from bank accounts. The first important difference is that workers generally cannot deposit any additional funds into the account. The account is funded through deposits made by employers and in nearly all cases accounts do not pay interest, nor do they provide reports to credit reporting agencies. Therefore, card users cannot use the account as a wealth accumulation tool nor to help build their credit history.

A second difference is that some payroll card accounts are not held under the name of the employee but rather are held under the employer's names. Depending on how employers set up their payroll systems, the account may be in the employee's name or it may be under the employer's name with a specific amount designated to each employee. A further complication is that some systems are run by nonbank vendors, often data processing firms that handle payroll operations, with a bank entity in the background. Thus, since some financial regulations that apply to consumer bank accounts do not apply to payroll accounts. Of particular note, not all of the requirements of the Electronic Fund Transfer Act and Regulation E apply to payroll cards. Among other things, Regulation E sets liability limits for losses, establishes an error resolution procedure, and requires that the consumer be provided with a periodic statement.

Other differences are functionality differences from system to system. One important function of the card is to get cash off of the card. Cardholders usually have the ability to make one free withdrawal a month via a designated ATM network. Other features vary. Some cards allow employees to withdraw money at any ATM, but can only be used for point of sale at specific locations that have an arrangement with the card issuer. Other cards feature various combinations of ATM, POS transactions, and bill-paying. The functionality of the card can vary drastically depending on how the system is set up -- they cannot always be used as widely as debit or credit cards.

### Benefits to Employers

Payroll cards present several benefits to both firms and to employees. As stated above, the main benefit to employers is in streamlining and reducing payroll costs. The costs saving for replacement checks alone, estimated at \$50 million annually, is significant (Urrico, 2004). Larger firms are often able to reduce the size of their payroll operations. Employees no longer need to take time off or use their lunch hour to deposit or cash their paychecks, leading to increases in productivity. There are also benefits for firms that have geographically dispersed employees such as trucking companies and airlines. Employees who are on the road and are unable to receive a paper paycheck may have to go several days without receiving their pay--the payroll card eliminates this problem.

### Benefits to Employees

Employees also receive substantial benefits from using the cards, especially unbanked workers. The cards reduce the need to carry large amounts of cash while also eliminating check cashing fees, although ATM fees may apply. Some assessments estimate that unbanked workers who use check cashing services pay up to 6 percent of their wages in order to receive their pay (Hochgraf, 2002). Workers that who regularly away from home or their place of employment can access their pay much sooner than they would be able to otherwise. The account could also provide remittance services that allow cardholders to send money throughout the United States and internationally. This service is particularly useful to Hispanics, one of the largest segments of the unbanked population.

For those who do not have a bank account, payroll cards provide a number of useful functions that allow workers to more effectively receive, spend and manage their money. Many cards carry Visa or MasterCard logos and can be used like debit cards, allowing users to make purchases through traditional interbank card networks. This can open up markets previously inaccessible by some segments of the population and provide a sense of empowerment to some individuals. Online bill payment is also an important benefit. Cardholders can use the card like a debit card to pay bills online through appropriate websites or set up their account to have bills automatically paid, depending on what features their system provides.

One creative benefit allows customers to have a line of credit they can use through their cards. Users are given a line of credit equal to a pre-determined percentage of their salary and the payments are strung out over several paychecks (Hochgraf, 2002). This kind of system has the benefits of giving users flexibility in their cash-flow management, avoiding payday and title loan fees, and may even allow them an opportunity to build up a credit history.

### Drawbacks of Payroll Cards

There are, however, several drawbacks to payroll cards relative to direct deposit accounts. As stated above, workers may not be allowed to deposit other funds into their payroll card accounts, and accounts usually do not earn interest. This prevents the account from being used to accumulate assets and build wealth in any meaningful way. Some workers may still have to use check cashers and money orders for other checks they receive and bills they need to pay.

There are also a number of fees that payroll card users must face. These fees depend on how each employer sets up the payroll card program, but often they include fees to use ATMs, to make point of sale purchases, and for attempting to withdraw more money than the cardholder has in his or her account. These sometimes obscure fees can be a particular source of concern and frustration for payroll card users. Although card providers are required to disclose any fees associated with using the card, it appears that users are not always knowledgeable about when fees apply.

## **Regulating Payroll Cards**

Congress has assigned the Board of Governors of the Federal Reserve System the duty of implementing a number of federal laws intended to protect consumers in credit and other financial transactions and to ensure that consumers receive comprehensive information and fair treatment. The Board's Division of Consumer and Community Affairs is responsible for drafting regulations and interpretations to carry out the purposes of these consumer protection laws.

Under a 2004 Regulation E proposal, the regulation would have been revised to provide that a "payroll card account" that is directly or indirectly established by an employer on behalf of a consumer, to which EFTs of the consumer's wages, salary, or other employee compensation are made on a recurring basis, is an "account" covered by Regulation E. The proposal applied all of Regulation E's provisions to consumers who receive their salaries through payroll card accounts, including the requirement to provide paper periodic statements.

One of the questions industry commenters requested the Board to consider was whether there is a need for, or the need to revise, the periodic statement requirement for payroll card accounts. Suggestions included permitting financial institutions to provide paper statements upon request, providing a readily available telephone line to obtain balances and transaction history, and/or internet access to transaction information.

### Consumer Focus Groups

The Board contracted with ORC Macro, a market research firm, to meet with payroll card users in order to learn more about what they think about their cards and how they use them. Participants completed a short, 14-question survey about how they accessed and monitored their accounts. Four groups were conducted, two in Ohio

and two in Michigan, with a total of 39 respondents. Nearly two-thirds (62%) of the participants were women. Most were over 36 years-old; only 25% (10 respondents) were 35 or under. There was only one Hispanic respondent; 59% were White and 38% were Black. Respondents were not asked any income related questions, but they were asked occupational questions. Most respondents were blue-collar workers, with only a few employed in managerial or technical positions. The payroll card program in Ohio provided a monthly statement detailing card activity and fees; the program in Michigan did not provide periodic statements.

In addition to getting consumer input on issues related to Regulation E provisions, we wanted to evaluate the extent to which payroll cards substituted for and traditional bank accounts in terms of functionality. We hoped to recruit both participants who had bank accounts and those that did not. This proved to be difficult -- in fact only two respondents never had a bank account and six others were currently unbanked. However, as will be described below it was possible to analyze the way consumers used payroll cards relative to checking and savings accounts

It is important to note that this is qualitative research. The sample size is small. Although respondents overall provided relevant and meaningful data and opinions, the number of participants reduces its external validity. While the data presented here are a good starting point for learning more about how consumer use and feel about payroll cards, more extensive survey data are needed to draw broad generalizations.

### Survey Findings

As is illustrated in Table 1 and Figure 1, many respondents actively used their payroll cards. Withdrawing money at an ATM and using the card to make a point of sale purchase were the two most popular ways of using the cards. The median number of monthly uses for each was 3 and 8, respectively. Respondents made equal use of ATM and POS to get cash off their cards -- 21 withdrew cash at an ATM at least once a month, while 18 received cash back with a purchase.

Figure 1  
How Consumers Use Payroll Cards

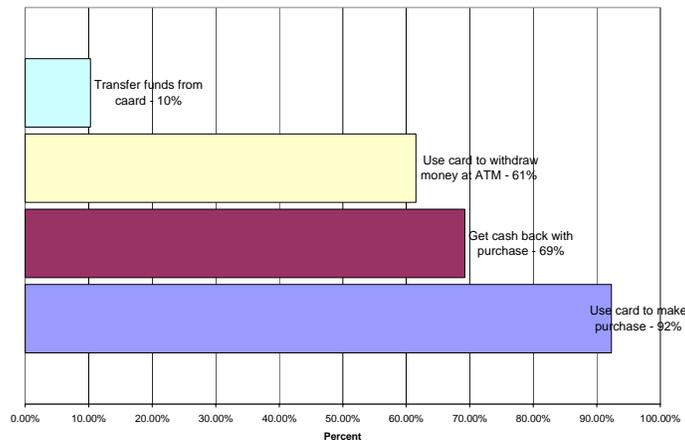
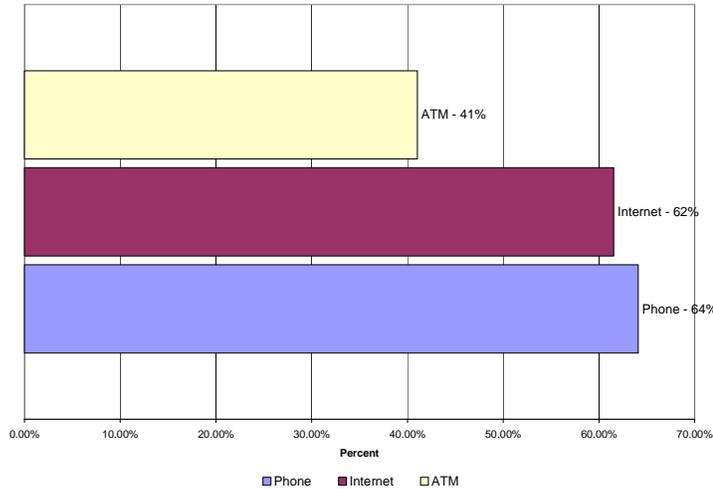


Table 1  
How Respondents Use Payroll Cards

	Made ATM Withdraw	Made Purchase with Card	Got Cash Back with Purchase	Transferred Funds from Card	Checked Balance at ATM	Checked Balance Over Phone	Checked Balance on Internet
Number of respondents	21	27	18	4	11	16	16
Median of users	3	8	3.5	2.5	2	4	4.5
Range	1 - 19	1 - 49	1 - 74	1 - 3	1 - 9	1 - 5	1 - 24

Card users were more likely to check their balance over the phone or online rather than going to an ATM, 41 percent as compared to 28 percent (Figure 2). This could be due to the fact that consumers may have to pay a fee to check their balance at an ATM, or it may just be more convenient to check balances via the other methods. Not only did more respondents use the phone and internet to check balances, but they often used these more frequently. At the median, consumers checked their balance twice a month at ATMs, but four times a month over the phone and via the internet.

Graph 2  
How Consumers Check Their Balance



We were interested in learning whether payroll card users treated their accounts as substitutes or complements to their existing bank accounts. Compared with other banked consumers, higher proportions of consumers with only savings accounts reported using their cards at ATMs, for purchases, and for getting cash back with purchases (Table 2), which leads us to conclude that payroll cards function as a complement to savings accounts. Lower proportions of consumers with both checking and savings accounts reported using the various functionalities of their cards, but among those that did use their cards at ATMs or to make purchases, they did so more frequently than those with only checking or only savings accounts.

Table 2  
Influence of Other Bank Accounts on Card Use

	Made ATM withdrawal	Used at POS	Got cash back with purchase	Transferred funds from card	Checked balance		
					At ATM	Over phone	On Internet
Checking account only (N = 6)	50%	67%	50%	33%	0%	50%	33%
Median	1	7.5	5	2.5	0	5	8.5
Savings account only (N = 11)	64%	81%	64%	0%	36%	55%	55%
Median	3	7	4	0	2	4	3
Savings and checking accounts (N = 14)	36%	57%	36%	14%	21%	29%	36%
Median	4	10	3	2.5	2	2	4
No checking or savings account (N = 8)	75%	75%	38%	0%	50%	38%	38%
Median	4	7	3	0	2	3	5

When it comes to monitoring account balances, higher proportions of the unbanked cardholders reported using ATMs to check their balances. Higher proportions of consumers with only savings accounts reported using the phone and the internet to check balances. Consumers who had both checking and savings accounts were the least likely to check balances at all via any of the three methods included in the study

### **Focus Group Comments**

For the most part, cardholders that participated in the study had a positive attitude towards payroll cards. Most preferred having their money deposited on the card rather than receiving a paper check. Many users liked the fact that they got their money faster and did not have to spend time waiting in line at a bank or check casher to receive their pay. They also liked the benefit of not having to carry around too much cash. For some, the card allowed them to better budget and manage their money.

#### Information Gaps

Some card holders were not well-informed about how to use the cards. One respondent commented that when he began his job he was not informed how he was going to get paid--he overlooked the card, not knowing what it was for. Education about the card was a problem for other users too, not just new employees. Many cardholders were not knowledgeable about how they could get money off the card, where they could use it to purchase goods, and when they were charged fees.

“So they have to come to me to get their name badge when they first start – along with it goes the paycheck card and I explain everything to them at that moment – what exactly it is. Because I deal with a lot of minors – we've got a lot of minors on board... that, you know, are lost when it comes to that. They've never had an ATM card, they have no idea what it is; so you have to explain it to them. Explaining it to them, a lot of times still, you're talking about a week later before they actually have the pay; so that's why I always tell them to come and see me on Friday morning, I'll walk you through it and show you exactly what to do, and it seems to work out a lot better.”

#### Fees Are a Concern

Issues with fees were among the biggest concern for cardholders. Most payroll cards allow a set number of “free” ATM withdrawals per pay period. However, while the card issuer may not charge a fee, the ATM owner or network may. In addition, some POS transactions carry a fee. Some respondents commented on hidden or unknown fees:

“Some of these corner stores still charge you and you never know. You go in there and...the card is supposed to be [just like] cash ...and you use it ... just for that sale item, and when you get your statement [there's] an extra charge on there, but it's not every store. Some stores are selective. I think the owners do [it] themselves. And then also you can't tell which stores they are because they always say well you got to spend a certain amount in here. I mean if it's cash, I can go in there and spend a dollar if I want to. A debit is supposed to be cash. But they tell you well you've got to spend at least \$3 or \$5, and then they [charge you].”

Fees strongly influenced how cardholders used their cards. For example as is shown in the Table 1, respondents favored checking their balances for free over the phone or online rather than using an ATM, because they did not like paying a fee:

“You can go to an ATM but there are charges that go along with that; so I try to avoid...the ATM, and I encourage my team members to stay away from the ATM. They start out at a very low [pay] rate as it is; taking more money away from them is not a good thing.”

“But before you do a transaction this is how they get you too. Before you do a transaction say you got if you have \$102 in the bank. You need to take out \$100 to pay a bill. This bank charges you a \$2.50 fee. They ain't going to get you no \$100.”

“Well, it depends on where you go because for example [...] if I go to the gas station on the corner and use their ATM, it’s a Bank One ATM. It charges me like ... a buck or something. If I go next door to the Huntington Bank, it [charges] you \$3.50 because you get Huntington’s charge...”

I have [...] people come up to me saying: ‘okay, I want my money.’ ‘Well, how much do you have?’ ‘I don’t know, approximately...’ [And I say], ‘don’t guess, [if] you guess wrong, and you’re over your limit – they’re going to charge you \$.50. And they don’t know that – nobody has told them that...And you keep guessing and guessing and guessing – it’s \$.50 each time you guess...

“I look at it when I see a dollar show up here five or six times, [I’m] being dollar and dollar and a half to death.”

“If I pay my gas bill with my card, they charge me five bucks. But I can write a check and it probably costs me a dime. So, if I paying my gas bill it gets paid out of the checking account. But my cell phone bill, there’s no charge for it. I punch in the little number and punch it through and they don’t charge me for it.”

### Account Management

In part because of these fees, cardholders need to do a good job of managing their accounts and paying attention to their balances. All cardholders checked their balances at least once a month and some almost once a day. While some users just paid attention to their balance, many users monitored individual transactions in order to avoid a denied transaction. There were also some cardholders who checked their accounts often because they were not very familiar with how the accounts operated and wanted to monitor them closely.

“And you can check your balance on that one. We do have [an intranet] system which [we have] because we’re paperless, so they said. Yeah, okay, tell my desk that. But they have a website that we can go into and find out what our hours are and what our pay is; and it shows how much is the deposit and on your paycheck card. But unless you draw all that money off right away, it’s not accurate. So I prefer that they go to the [payroll card internet site] because it gives them an accurate balance. A lot of times when they go into [the intranet site] and they don’t remember they haven’t taken all their money off and they try to go take the amount off, it’s... there’s not enough money there. There’s less money there than what the [the system] was telling them. It starts charging them \$.50 every time that they get it wrong. That, I have an issue with.”

Several groups of cardholders emerged in the focus group discussions. One group made much more limited use of the card. These cardholders withdrew their entire paycheck as soon as it was available.

“I strictly just get my entire amount of whatever’s been credited to my account out and cashed from the service desk at the store.”

Another group made active use of the card, almost treating it like a checking account. These cardholders used the card to make purchases and pay bills as they would with a debit card and bank account or kept funds on the card for special purchases. Some used the card as a budgeting tool by putting a small amount of money on it for lunch or recreational activities:

“I don’t take all my money off of it. I use it just like a checking account – I leave my money in there and use it as I need to.”

“I run mine just like a checkbook – I put all my deductions in there and I balance it out that way. If I think something’s wrong, you can click on “card activity” and it shows everything you’ve done with that card since you had it. And that’s as a convenience I think...”

“I take a certain amount out of my check each week, so it’s the same thing every week, every week, every week; so I know what I do. And I just use it for like a big credit card bill. So it’s more than what my paycheck is one week so I just do it that way... once a month I take it out to the pay those two bills and it [then] builds up for the next four weeks.”

“I use my payroll card basically for my fun money [and] I’ll use my checking account for monthly bills and stuff like that. But then all my excess money goes on the pay card, and I use that for like lunch or gas or hanging out or anything like that. And when that money is gone you can’t go out anymore. So, I guess you can say it’s kind of like a savings vehicle because I put a certain amount of money. When that money is gone and it’s the beginning of the month or the end of the month you can’t hang out anymore.”

For some consumers, the payroll card is a tool that helps them exercise some self-control in their spending habits. Since most cardholders in the survey had low or moderate income, this aspect of the card seemed to be a significant benefit.

“I put my grocery money on there, gas money, cleaners and if you’re getting books or something like that. So, it helps me to manage what I’m spending. So, when I look at my card and you spent a whole lot at the market then you don’t get any books.”

“I’m surprised they came out with that card though because I’m having more money. When they used to give us a check I would be broke. I know I ain’t going to never be broke. I have some money from pay day to pay day now.”

### Paper Statements

One of the main purposes of the focus groups was to assess how consumers accessed information on their accounts and the merits of periodic statements. As indicated earlier, one set of participants received statements while the other did not. Those receiving statements were somewhat split on their opinions about these statements -- some liked getting a paper statement each month and other believed it was unnecessary. The participants that did like getting a paper statement believed the statement provided them with a more comprehensive overview of their spending habits and a helped them to monitor their spending. Others liked the idea of getting a statement in order to file in their records for tax and bookkeeping purposes.

“Just for reference really in case something comes up I can take a look [at the statement] just to keep an idea of where my spending habits are too. Sometimes you want to adjust your budget to look where you’re spending.”

“When you’re trying to manage your money, it’s hard when you don’t see what you’re doing with it. Like you can make a mental note but that’s not really realizing like ‘wow I spent two thousand dollars this month on this and I can’t believe that it really came out to be that way, like I can’t believe what I made that month and then spent only a fraction on what I’m supposed to.’ So, you need [the statement], especially for people like me who need money management.”

Paper statements also helped provide a way for cardholders to check for errors. Although such errors did not appear to be a big concern for the respondents, those who preferred a paper statement cited this issue as a reason for their opinion.

Cardholders who did not view paper statements as particularly useful preferred to manage their accounts online or over the phone. They saw the paper statements as out of date and not particularly useful in their need for up to date information. Others raised concerns about identity theft. One opponent of paper statements did not like the idea of his personal information going through the mail,

“I don’t want to have [paper statements] because frankly [they have] too much personal information. I don’t want all that information floating around in my mailbox.”

“I live in townhouses. And probably once a week at least me and the neighbor go outside and go “have you got my mail?” and she goes “yeah, have you got mine?”. And there’s like four of us in a row, and the postman can’t seem to get 517, 515, 513. So, we stand on the front porch and like let’s trade mail. And I mean if somebody wasn’t paying attention and opened it. I mean I know my neighbors. I mean I feel pretty confident saying I don’t think anybody... but what if he sent it down the street?”

Even with different opinions on the need for paper statements, all individuals agreed that if they had to choose between paying a fee for paper statements or checking their balance for free online or over the phone, they would give up paper statements.

### **Future Directions for Payroll Cards**

The Board's interim final rule for Regulation E provides for the same liability and error resolution coverage for payroll cards as for other consumer deposit accounts. As an alternative to providing periodic statements, institutions may instead:

- (1) make available to the consumer the account balance through a readily available telephone line;
- (2) make available to the consumer an electronic history (such as via an Internet web site) of the consumer's account transactions that covers at least 60 days preceding the date the consumer electronically accesses the account; and
- (3) provide promptly upon the consumer's oral or written request, a written history of the consumer's account transactions that covers at least 60 days preceding the date of receipt of the consumer's request (to allow consumers to assert an error and seek resolution).

According to one study less than 10 percent of the market for payroll cards has been realized (Frumkin 2005). Firms may not be aware of the availability of the cards and of the potential cost savings associated with them, while employees are not aware of payroll cards or are not motivated to overcome their desire for a paper check. The latter problem is especially relevant in the Hispanic community where receiving a paper check is still the preferred method of receiving pay. In a survey by the Kansas City Federal Reserve Bank, a majority of Hispanic respondents (56%) said they would not feel comfortable receiving their pay on a plastic payroll card (Robbins 2006). While the unbanked segment of the population stands to receive the greatest benefit from using payroll cards, because of their unfamiliarity with cards and other financial instruments, they are likely to be distrustful of these kinds of products.

Banks may be motivated to work with local employers to offer payroll card programs in order to move cardholders into traditional bank accounts. In one survey of banks, however, no specific strategy to use the cards as a "proto-account" was identified (Frumkin 2005). Banks that provide the cards appear to treat it as just another financial product rather than a marketing tool, this is probably short sighted. For example, a study of the Bank of America payroll card system users found that two-thirds would likely purchase additional financial products from the bank (Harris 2004).

Probably the most pressing and important issue related to payroll cards is the laws and regulations that cover them. The issue is particularly relevant because it is not always banks that operate the program, but rather third-party vendors in a partnership with banks. Other issues, such as whether the funds are FDIC insured, remain to be resolved. The FDIC has proposed regulations to clarify when stored value cards, such as payroll cards are to be deemed deposits and thus insured (Frumkin 2005). These regulations and consumer protection issues are vital to the consumer acceptance of the product and the expansion of payroll card programs, as is information on helping consumers manage their money with these new financial tools.

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#### Endnotes

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<sup>3</sup> Payroll cards are a sub-set of stored value/prepaid cards. For more information on this broader class of products, see Cheney, 2005a; Cheney, 2005b; Furletti, 2004; Hunt, 2003; McGrath, 2005; Rhine and Su, 2005.