

## Payments Newsletter: July 2007

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UPDATE

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### IN THIS UPDATE

Welcome to the summer issue of our Payments newsletter for clients and friends of the Payments Advisory Research Service. You do not have to be a Payments research client to receive this newsletter, although a subscription will be needed to access the Financial Insights reports we reference, or to obtain more detailed coverage.

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### A Thousand Points of Light

From time to time, we hear about innovative payment ideas that have taken root in a small area; just a few merchants, or a single restaurant chain, or even a single town. It's hard for us to cover these in the regular service, because the chances that they are ever going to hit on a national scale are very small. However, the fact that these payment systems exist refute the myth that merchants and consumers are all conservative or hate to try new things. In fact, many people love novelty, and being on the cutting edge. Take all those who lined up to buy iPhones, for example (although that is perhaps not such a good example, having a huge hype engine behind it). Why some ideas take off and others don't is a question that social scientists will continue to ponder, but in the meantime we will cover a few of them in this newsletter, in the hopes that someday they may attain a level of acceptance that will allow us to devote a whole report to them.

This month's selection is BerkShares, described in a Reuters article from June 19, 2007. Named for the region of Massachusetts where they are used, the Berkshire Hills, BerkShares is actually a unique local currency, accepted at about 280 local merchants in lieu of cash. The currency is sponsored by a local non-profit, BerkShares, Inc., which in turn is sponsored by a coalition of local development agencies and businesses seeking to promote economic development in the southern Berkshire region of Massachusetts. There are four banks that currently exchange dollars for BerkShares, at a rate of 100 BerkShares for 90 US dollars: Berkshire Bank, Lee Bank, and Salisbury Bank. BerkShares are printed in denominations of 1, 5, 10, 20, and 50.

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The main idea of BerkShares is to keep money in the local community by encouraging residents to spend with local businesses. The exchange rate on BerkShares results in an effective 10% discount on everything bought with the currency, but it may only be used at businesses that accept it, and those businesses are (so far) only located in the southern Berkshires (Great Barrington and the surrounding communities). Of course, the discount by itself is not intended to be the sole focus of the program; the design of the bills and the simple fact of carrying them identifies the consumer as a member of a group that cares about their community and its economic health is also key. It also redirects economic activity away from the Internet and toward face-to-face interaction, reinforcing social ties. In effect, there is a far-reaching social and economic agenda behind the program that makes it far more than your typical 1:100 or 1:200 loyalty program.

According to the Reuters article, this is not the first program of its kind; there are similar groups operating in California, Kansas, Michigan, New York, Oregon, Pennsylvania, Vermont and Wisconsin. One of the oldest is Ithaca Hours, which went into circulation in 1991 in Ithaca, New York. The BerkShares program is being evaluated this summer for potential expansion into checking accounts and debit cards, with a decision expected to be announced by September 30, 2007.

We believe this is a good example of how community banks can use payments to strengthen relationships with local merchants, build their deposit base, and defend against regional and national banks, all without a huge outlay in technology. It maximizes the natural advantages of the community bank: its deep knowledge of the local geography, its nimbleness, and its integration into the social fabric. This is not to say that larger banks have no interest in participating in these programs; just that community banks have the most to gain. We look forward to following the progress of this program, an encouraging example of doing well by doing good.

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### **The Enemy Within?**

There was much rejoicing four months ago when Wal-Mart's application for an industrial loan charter went down to defeat. At last banks could breathe easy; their biggest threat had been vanquished. Or had it? Turns out a bigger threat may have been right next door the whole time. On June 5, 2007, the American Banker reported that Capital One was partnering with MasterCard to introduce a debit card that would work with any checking account, using the ACH network to transfer funds. Turns out they'd been doing it since March, actually, sending out the debit cards to existing credit card customers, and allowing them to earn reward points that would be pooled with the reward points on their regular credit cards.

In our November 2006 report, "Winning the Interchange Wars by Opening the Network," we wrote that "as MasterCard and now Visa go

public, their motivations will shift from servicing bank owners to rewarding stockholders, many of which will be merchants. Therefore, it is likely that both card associations will develop more products and services specifically aimed at merchants that may tend to reduce the power of issuers to control the terms of the transaction."The Capital One/MasterCard announcement is an important early example of this sort of product, since it could easily be issued by a merchant instead of Capital One. In fact, on June 25, 2007, American Banker reported that the Sheetz convenience store chain had begun issuing the Capital One cards.

This development actually followed a similar move by HSBC, whose retail services division agreed in March to offer the Tempo Payment Network (formerly Debitman) OptiPay loyalty rewards PIN-based ACH debit card to its retail customers (see "HSBC to Roll Out PIN-Based Loyalty", May 2007). In this scheme, the merchants will be able to offer a merchant-branded card to their customers, with HSBC handling all the application, issuance, fulfillment, marketing, and customer service work. Each time the card is used, the merchant will receive a portion of the interchange, with Tempo and HSBC sharing the rest. Concept Shopping Inc., a Lisle, Ill.-based retail marketing and rewards firm, is providing the loyalty services for the product, giving it the extra boost needed for consumer and merchant acceptance. On June 11, 2007, American Banker reported that CVS Corp. will be the first merchant to start issuing the cards, starting in August in Indianapolis.

We are now starting to hear about more of these ACH debit card schemes, and it seems clear that one of them is going to get some volume going. And every one of them has a bank behind it. Some banks, like HSBC's retail-services division, cater to merchants, and push their objectives. You can debate whether these entities should properly be called "banks" or "financial institutions" or "financial services firms" or whatever - the point is, it's too late now, and it was too late long before Wal-Mart had the temerity to apply for its ILC charter. The debit card market is opening up, and banks will no longer have exclusive access to their deposit account customers. On July 17, 2007, Tempo announced the release of the Tempo™ Payment Platform and Tempo Debit, a prepackaged version of the HSBC product that will make it possible for any financial institution to issue an ACH debit card. It's everyone for themselves now.

Oh, and by the way - Wal-Mart announced on June 20, 2007 that it is going to open 1,000 financial service centers in its stores by 2008, focusing on the "unbanked" with services like check cashing, money orders, money transfers and bill payment. And most of its stores will soon offer the Wal-Mart MoneyCard, a reloadable prepaid Visa, that is being offered through GE Money and Green Dot. It sure is great that ILC application was defeated - isn't it?

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## **Where's the Bank?**

Expanding on the previous segment, a MasterCard Worldwide press release on July 10, 2007 announced an agreement with the Green Dot Corporation to link the MasterCard rePower prepaid card reload network to Green Dot's network of about 40,000 retail locations nationwide, including Wal-Mart, CVS/Pharmacy, Walgreens, Rite Aid, and Radio Shack. The cash taken in for these reloads, except for that used in the daily operations, would presumably be sent to a bank for deposit. The explicit target for these prepaid cards are the unbanked, the 12-13 million Americans with no bank account.

Conspicuous by their absence were the banks. Not a single bank name appeared anywhere in the release, yet a bank must have been involved, if only to rent out the PIN numbers. Why are banks ignoring this opportunity? We find this surprising, given all the ink and hot air that has been expended on the subject of penetrating the unbanked market. Just think of all the traffic this reloading will create, and the opportunity to build relationships or sell additional services! Why are banks not more visibly involved here? They could be promoting their names and building relationships with the merchants that participate in the reload networks. They could be picking up deposit accounts, sharing in the transaction fees, and adding to their portfolio of Community Reinvestment Act activities. Perhaps today's branches are not designed to accommodate the sale of prepaid cards, but this may provide a clue as to one reason why the unbanked remain unbanked. With branch traffic about to decline as businesses switch over to remote deposit capture, the unbanked could be an important source of new business. Reconfiguring branches to handle prepaid card sales could open the way to sales of other new products as well.

It seems to us that banks should be participating in these press releases and starting their own similar initiatives. Taking a suggestion from the BerkShares program we discussed in the first segment of this newsletter, perhaps a greater focus on what is happening on the community level and on leveraging the branch office is a way to battle the continual erosion of customer relationships represented by products like the ACH debit card.

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## **Payments Research Update**

We are proud to announce a large quantity of new reports released in the service in the past month: forecasts of card and check transaction volumes, along with a forecast of remote deposit capture spending and a market overview of prepaid health care cards. We are now turning our attention to a follow up survey on prepaid health care cards, a broader forecast of prepaid cards, a review of progress in mobile payments, an update of payments IT spending, a summary of two major surveys of banks and businesses on the subject of commercial payments and lending, and an enterprise payments case study. All of these will be coming out in the next couple of months. As a client of

the Payments advisory service, these reports may be downloaded using your logon and password. All others may purchase the reports simply send an email to us at: [sales@financial-insights.com](mailto:sales@financial-insights.com)

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### **Closing Remarks**

We hope that you are enjoying your summer reading (including this newsletter) and we do encourage and appreciate your thoughts on each issue. Simply send us a quick note via email to either one of us. And thank you again for reading.

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