

Debit Cards, Prepaid Cards, and Electronic Transfers

by Sophia



WHAT'S COVERED

In this lesson, you will identify the differences and similarities among debit cards, prepaid cards, electronic transfers, and checking accounts and how they help increase productivity. You will also explore how technology and agility skills can help you use them. Specifically, this lesson will cover:

1. Purchases and Transactions

As recently as 1995, the majority of spending transactions in the United States were made with a check. However, the days of pen-and-paper transactions as the primary method of doing business are gone forever. In today's fast-paced world, **electronic transactions** – payments made at the time of a purchase and transfers of money from one account to another – are quickly becoming the standard. They're not, however, the only approach. This topic provides information about the three main ways consumers make transactions today: (1) traditional, (2) electronic, and (3) hybrid transactions.



WATCH

No matter which transaction type you choose, it's important to spend money wisely and to stay within your budget. Check out this video about spending responsibly before moving on to section 1a.



TERM TO KNOW

Electronic Transaction

Payments made at the time of a purchase and transfers of money from one account to another.

1a. Transaction Methods Used

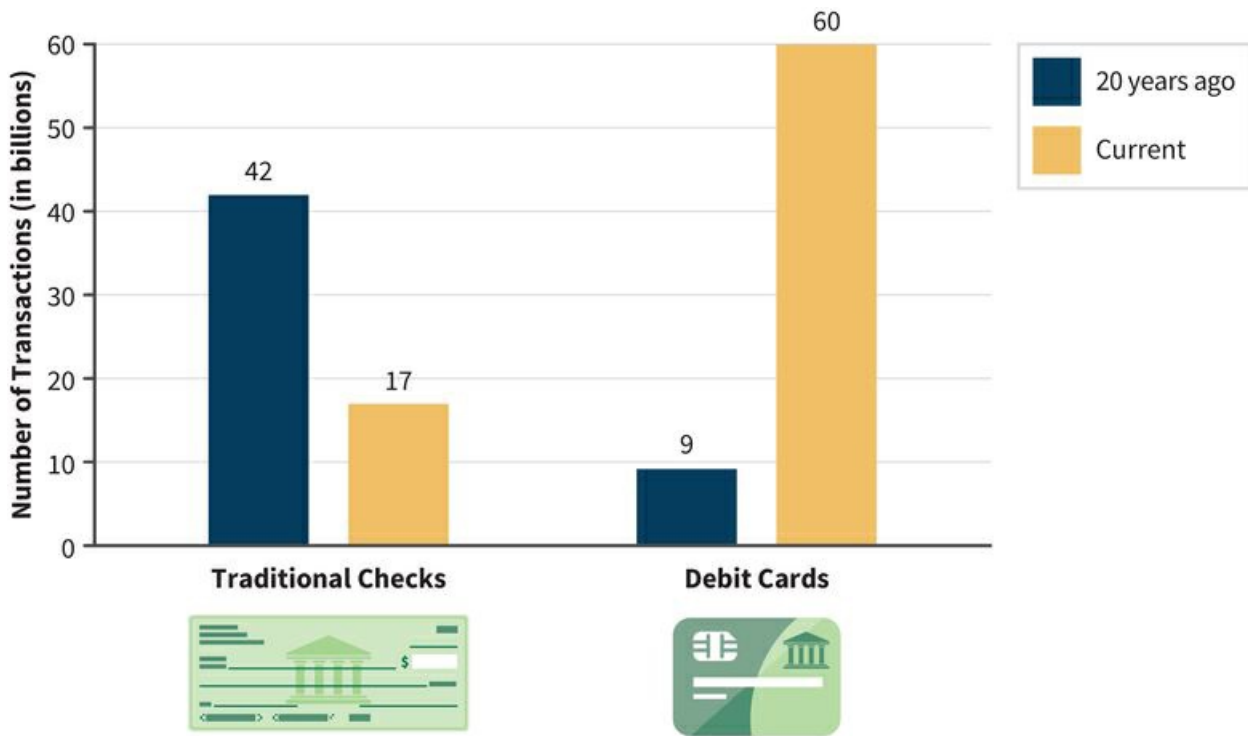


DID YOU KNOW

Today, the number of electronic transactions is larger than all other traditional methods used to make purchases and transfer money.

Look at the following column chart; two things should stand out immediately:

1. People still write many checks; however, the number of checks being processed has fallen by more than 50% since 2000.
2. The number of debit card transactions has increased more than 600% over the same period.



Source: Board of Governors of the Federal Reserve System.

Although the volume of transactions is now clearly dominated by debit cards and other electronic forms of payment, this doesn't mean that the simple checking account is going away any time soon – in fact, the opposite is true. Access to a checking account is even more important today than at any time in the past.



BIG IDEA

A checking account gives consumers access to the world of electronic transactions.

1b. How Payments Are Made

Let's look more closely at the way most goods and services are purchased and how cash is transferred today. Payments made in the United States can be classified into three groups:

1. Traditional methods, including cash, coins, and checks.
2. Electronic payments, such as debit cards and prepaid cards.
3. Hybrid methods, a combination of traditional methods and electronic payments.

We will explain electronic payments and hybrid methods in more detail in a moment. Before we do, let's review the traditional methods. Whenever you make a purchase using cash, coins, or checks, you are using the oldest and most traditional form of payment. Although traditional transactions often make sense, it's important to remember that you have no protection if your cash is stolen or lost. Credit cards are another form of payment that many people use, but note that the ultimate payment to the credit card company must be made using one of the methods described in this topic. We discuss credit cards in more detail in a later topic.



Technology: Why Employers Care

Many employers today pay their employees by direct deposit. A direct deposit, in banking, is a deposit of money by a payer directly into a payee's bank account. It is important that you, as an employee, are able to use your technology skills to access the information needed to set this up.

2. Electronic Payment Methods

Whether it's the total volume of transactions or the dollar value of transactions, electronic payments dominate the payment and transfer options used by consumers today. The table below lists and defines most of the electronic methods currently available and frequently used. The following discussion highlights the role of debit and prepaid cards.

Type of Payment Method	Description
Debit card with PIN	Payment made directly from cardholder's checking account using a personal identification number (PIN) to verify the transaction.
Debit card with signature	Payment made directly from cardholder's checking account using cardholder's signature to verify the transaction.
Prepaid card	Payment made from money loaded onto the card in advance to make payments in the future.
Direct debit	Payment made electronically without a debit card.
Electronic bill-paying service	Payments made by direct debit from an account holder's bank through a noncard-payment network (e.g., the preferred way to pay federal income taxes).

Source: Fumiko Hayashi and William R. Keeton, "Measuring the Costs of Retail Payment Methods," Economic Review 2 (2012). Retrieved from <http://www.kc.frb.org/publicat/econrev/pdf/12q2Hayashi-Keeton.pdf>.

2a. Debit Cards

When you open a checking account, you'll be offered a debit card as a component of your account.

- Debit cards are marketed as a substitute for traditional paper checks. The key difference is that with a check, money is usually transferred from your account to the merchant only after the seller deposits the check. With a debit card, the transaction occurs instantaneously.
- A debit card works well for those who would otherwise overspend with a credit card. Without **overdraft protection**, which allows someone to spend more than their account balance, you can't spend more than what is in the account. On the other hand, this can limit your options, especially in the case of an emergency.
- A less expensive alternative to overdraft protection is overdraft protection transfers. Overdraft protection transfers automatically move money from your savings account to your checking account. There are limits on the number of transfers that can be made each month, so the best option is to simply make sure you have enough money in your account to cover the expense.



TERM TO KNOW

Overdraft Protection

A bank service that allows someone to spend more than their account balance.

2b. Prepaid Cards

A **prepaid card** consists of money loaded on to the card in advance that can then be used to make payments in the future. Unlike a debit card, you don't need a bank or checking account to get a prepaid card. You can put money on a card via an online transfer, in person, or direct deposit. Keep in mind, however, that most prepaid cards charge a variety of fees and are a higher cost alternative to debit cards.

A few words of caution are needed about prepaid cards.

- The numbers and types of prepaid cards are varied. For example, firms as diverse as restaurants, department stores, and online retailers offer prepaid cards.
- Some prepaid cards may only be used to purchase goods and services from one retailer. Other cards, such as the WalMart® MoneyCard, can be loaded with money and used worldwide wherever Visa® or MasterCard® are accepted.
- Generally, prepaid cards should be considered similar to cash, with little **fraud protection**, which is assistance in case a prepaid card is lost or stolen. For example, some prepaid cards will reimburse only up to \$500 for fraudulent purchases.

Given the limited fraud protection and potentially higher fees, debit cards tend to be a better method of payment than prepaid cards.

Debit cards and prepaid cards have many benefits. You can flex your **productivity skill** with these financial tools by moving money instantly and spending within your means. Decide for yourself whether debit cards and prepaid cards are right for you.



TERMS TO KNOW

Electronic Transaction

Payments made at the time of a purchase and transfers of money from one account to another.

Fraud Protection

Assistance in case a prepaid card is lost or stolen.

3. Hybrid Payment Methods

The line between checks, debit cards, prepaid cards, and other forms of electronic payments – online payments, mobile transfers, smart cards, and **peer-to-peer payments (P2P)** – is quickly blurring. Things have gotten even more complicated with the addition of smartphone payment options.

- Peer-to-peer payment (P2P) apps allow you to transfer money from your bank to someone else in your personal network.
- The transfer occurs from one smartphone to another.

Banks, credit unions, and other financial institutions are always looking for ways to move money faster and improve the buying experience, such as **cryptocurrencies** like Bitcoin. These hybrid currencies act like cash but work like P2Ps.



TERMS TO KNOW

Peer-to-Peer Payment (P2P)

Apps that allow you to transfer money from your bank to someone else in your personal network.

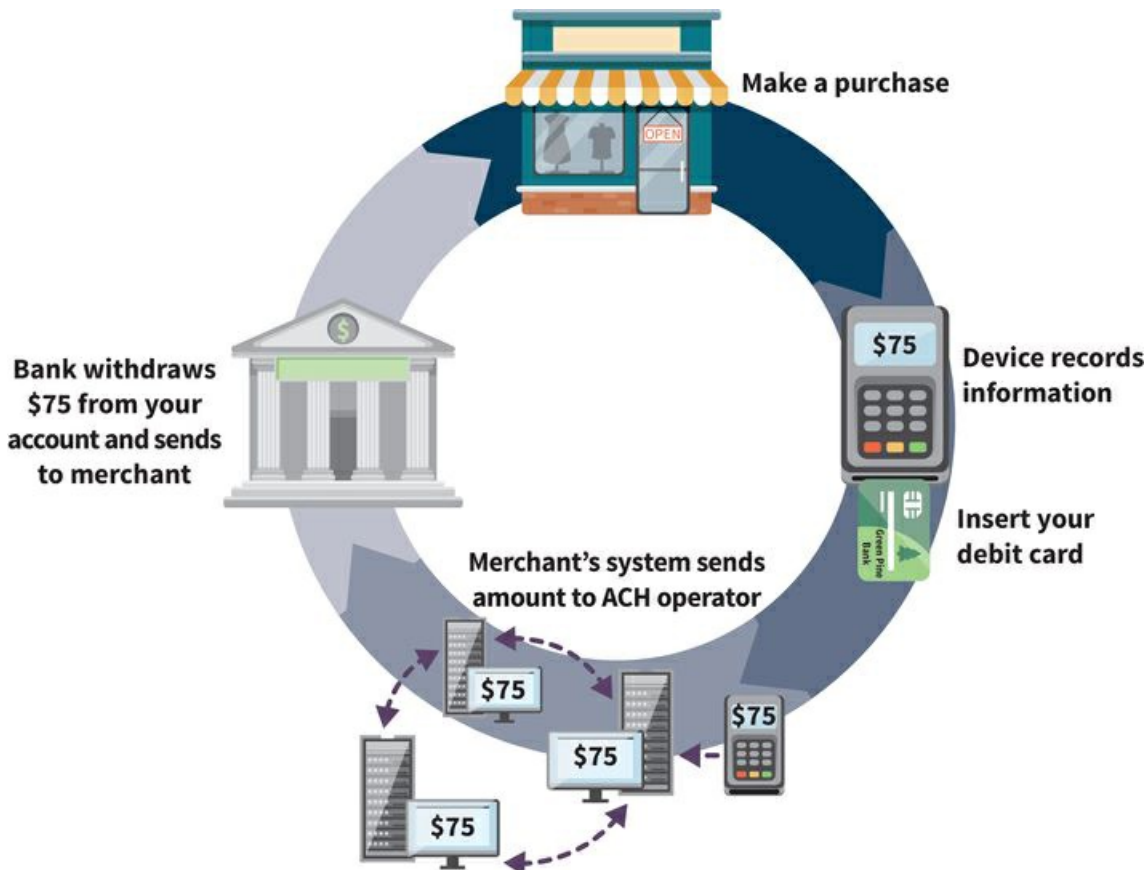
Cryptocurrency

A hybrid currency that acts like cash but works like P2Ps.

3a. Automated Clearing House (ACH)

The role of the **Automated Clearing House (ACH)**, which is a nationwide network of banks, credit unions, and other depository institutions that send each other credit and debit transfers electronically, is growing in importance.

- ACH transactions make up a high percentage of all payments made in the United States, and the volume of these types of transactions is increasing by nearly 5% annually.
- Credit transfers include wages, salaries, Social Security benefits, and tax refunds; debit transfers typically are payments for mortgages, utility bills, and credit card payments.



3b. Check-to-Electronic Conversion

Another type of hybrid method is the **check-to-electronic conversion**. With this method, payment with a paper check is immediately converted at the point-of-sale terminal (such as at the check-out counter at the grocery store) to an electronic form of payment. The table below summarizes the key features of ACH payments and check-to-electronic conversion methods.

Peer-to-peer (P2P)	P2P apps allow you to transfer money from your bank account to someone in your network. The transfer occurs from one smartphone to another.
Automated Clearing House (ACH)	Payments made directly through electronic fund transfers; similar to electronic bill-paying services but broader in transacting both debit and credit transactions.
Check-to-electronic	Payment made at point of sale with paper check that is immediately converted to an electronic form of payment.

4. Choosing the Best Payment Method

Which is the best payment method: a check, a debit card, or a prepaid card? As you might imagine, the answer depends on whom you ask. Some people like checks because it makes it more difficult to buy things on impulse. After all, you must have your checkbook with you, and checks also provide a nice paper trail of expenditures. Some consumers prefer debit cards because purchases can be made quickly and efficiently. Others prefer prepaid cards, most often because they do not have a checking account.

Your choice may also depend on the situation. Being familiar with all types of payment methods will allow you to stretch your **agility skill** and make the best selection given the circumstances.

As you can see, checks, debit cards, and prepaid cards each have advantages and disadvantages associated with their use. The following table compares some of the features of debit cards and prepaid cards that you should consider as a way to make the best informed choice given your unique situation, goals, and financial resources.

Factor to Consider	Debit Card	Prepaid Card
Insurance if financial institution goes out of business	FDIC or NCUA insurance up to \$250,000	Limited loss liability
Fraud protection	<ol style="list-style-type: none"> 1. If card reported lost before any unauthorized withdrawals, your loss liability is limited to \$0. 2. If loss reported within 2 business days after card lost, your loss liability is limited to \$50. 3. If loss reported after 2 business days but before 60 days, your loss liability is limited to \$500. 4. You have unlimited loss liability after 60 days. 	Unlimited loss liability (some card issuers may provide limited protection)
Fees	Generally low or no fees but potentially: <ul style="list-style-type: none"> • Lost card fee • Out-of-network ATM transactions 	Generally higher fees than debit cards; fees may be charged for: <ul style="list-style-type: none"> • Monthly maintenance • Load and reload of funds • ATM transactions • Card replacement • Card balance inquiries



SUMMARY

In this lesson, you learned about **methods for making purchases and transactions** and how they can increase productivity. **How you make payments** for goods and services is tied to your financial security, technical skills, and effectiveness at managing your money. In the last 20 years, **electronic payment methods** have surpassed more traditional payment methods because of their immediacy. Consumers appreciate the convenience of **debit cards**, **prepaid cards**, and **hybrid payment methods**. Each method is based on the electronic transfer of cash. For example, the **Automated Clearing House (ACH)** can send cash between banks at the click of a button. And **check-to-electronic conversions** move consumers from traditional spending methods (i.e., paper) toward more virtual methods.

So, how do you **choose the best payment method**? The answer is not a simple one. Each method has its pros and cons given your financial situation and goals. Strong agility skills will allow you to use the best option for any given situation.

Source: This content has been adapted from Chapter 5.2 of *Introduction to Personal Finance: Beginning Your Financial Journey* Copyright © 2019 John Wiley & Sons, Inc. All rights reserved. Used by arrangement with John Wiley & Sons, Inc.

Wiley and the Wiley logo are trademarks or registered trademarks of John Wiley & Sons, Inc. and/or its affiliates in the United States and other countries.

REFERENCES

Hayashi, Fumiko, and Keeton, William R. 2012. "Measuring the Costs of Retail Payment Methods." *Economic Review* 2.

Retrieved from www.kc.frb.org/publicat/econrev/pdf/12q2Hayashi-Keeton.pdf



ATTRIBUTIONS

- [Comparison of Transaction Methods](#) | Author: Board of Governors of the Federal Reserve System | License: Public Domain



TERMS TO KNOW

Cryptocurrency

A hybrid currency that acts like cash but works like P2Ps.

Electronic Transaction

Payments made at the time of a purchase and transfers of money from one account to another.

Fraud Protection

Assistance in case a prepaid card is lost or stolen.

Overdraft Protection

A bank service that allows someone to spend more than their account balance.

Peer-to-Peer Payment (P2P)

Apps that allow you to transfer money from your bank to someone else in your personal network.

Prepaid Card

Money loaded onto a debit card in advance that can then be used to make payments in the future.