

Prepaid Cards: Advantages, Disadvantages, and How to Choose¹

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Overview

Prepaid cards are becoming popular among consumers, gift givers, employers, and even the Social Security Administration. Similar to gift cards at specific retailers, prepaid cards allow individuals to load the cards with a specific amount of money and use them for purchases. However, unlike store gift cards, prepaid cards typically display the logo of one of the major credit card companies (Visa, American Express, MasterCard, Discover) and allow the user to make purchases anywhere that the credit card company is accepted. Generally, the individual can spend only the amount that they “prepaid” on the card, but they can add more money, or “reload” the card at any time. This article will present the advantages and disadvantages of prepaid cards and then explain how to choose the best prepaid card, should you decide to use one.

Advantages

The main advantage of prepaid cards is convenience. They work much like bank debit cards, in that you can generally use them anywhere credit/debit cards are accepted. There are no credit requirements to obtain one of these cards, as you are not borrowing money. They are not linked to a checking account, and are available at many discount and drug stores.



Figure 1. Translucent debit card

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These cards can be convenient for parents to use with children, because they can put a specific amount on the card for their child to use. They can also be used for online shopping. Most prepaid cards do not allow you to spend more money than what you prepaid, making overdrafts less of a worry; however, it is important to check the terms on your card, as some do have overdraft capability and associated fees.

Prepaid cards can also be used to receive government benefits (i.e., the Direct Express[®] debit card used for Social

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Security payments) or to receive wages on a payroll card in place of a paycheck with some employers. These are generally used when individuals do not have a bank account for direct deposit of funds.

Disadvantages

While prepaid cards do have some potential advantages, they have several big disadvantages. First, since they are not considered a form of credit, they do not help to build credit history. It is important to understand that even though prepaid cards usually have a credit card company logo on them, they are NOT credit cards. You are using your own money instead of borrowing it and paying it back; credit is not used.

The second big disadvantage is that prepaid cards tend to have a lot of fees that take away from the amount of money you loaded on the card. These can include, but are not limited to, activation fees (for activating the card), ATM withdrawal fees (for getting cash at an ATM), monthly maintenance fees (just for having the card), balance inquiry fees (for checking to see how much you have left on the card), transaction fees (for making a purchase), and inactive account fees (for not using the card in a 12 month period). These fees can add up to a lot of money just for the convenience of being able to use plastic!

In addition, it is important not to look to prepaid cards as a permanent replacement for checking or savings accounts. People with bank accounts spend a lot less to manage their money, because there are so many more fees associated with prepaid cards. Bank accounts also come with the added benefit of earning interest, being able to write checks, access to various savings vehicles, and more federal protections. For instance, if your bank debit card is used fraudulently, there are federal laws that help you get your money back. However, if your prepaid card is lost or stolen, there is the potential for losing all of the prepaid balance if it is not reported in a timely manner.

How to Choose a Prepaid Card

If after weighing the advantages and disadvantages of using a prepaid card you decide to use one, you should consider several things in choosing the right prepaid card for your needs. First, look at the fees. Read ALL of the information that comes with the card (yes, even the small print), so that you can see which fees are avoidable (like ATM withdrawal fees) and which fees are mandatory (like an account activation fee).

Second, look into the level of fraud protections offered with the prepaid card. In other words, what will happen if it is lost or stolen? For example, payroll cards are subject to certain federal requirements and protection against fraud, but not all cards are subject to these federal protections. Other cards may offer protections through the card company, but you have to complete certain steps in order to receive those protections. For instance, you may have to register your card in the protection plan and/or report the fraud within a certain amount of time to be reimbursed for fraudulent charges. Some may have a limit on the amount that can be reimbursed.

Lastly, it is important that you be proactive in protecting yourself from fraud or theft. Treat your prepaid card like cash. Also, be very careful about accepting offers to purchase a prepaid card for less than the face value (or how much it is worth). This could be an indication that the card is stolen. It is important to check your card when you first get it to make sure that none of the protective stickers have been tampered with or removed. In addition, review your monthly statement right away to make sure everything is correct and that you have not been a victim of fraud. This applies regardless of whether you get your monthly statement in the mail or online.

Prepaid Card Comparison

Use a chart like the one featured in **Table 1** to compare prepaid cards and choose the one that is best for you.

Sources

O'Neill, B. (2011). Credit Card Rules for Young Adults. Retrieved October 13, 2011 from <http://www.extension.org/pages/25272/credit-card-rules-for-young-adults>

FDIC. (2009). Prepaid cards: Another way to pay, but understand the downsides. FDIC Consumer News. Retrieved October 13, 2011 from <http://www.fdic.gov/consumers/consumer/news/cnfall09/Fall09BW.pdf>

Table 1. Comparing the features of various prepaid cards helps consumers make decisions that are more informed.

Card Name	Activation Fee	Monthly Maintenance Fee	ATM	Balance Inquiry Fee	Inactive Account Fee	Transaction Fee	Other Fees	Fraud Protection