

Emerging Trends in Stored Value and Prepaid Cards

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**Carol R. Van Cleef
Judith Rinearson
Patrice Motz
Maureen Sanders**



A Broader PerspectiveSM

Agenda

- **Introduction**
 - Snapshot of the industry today
 - New products in the marketplace
- **Regulatory update**
 - State and federal laws
 - Hot legal topics
- **Money Laundering and Terrorist Financing Risks**
- **Questions and Answers**

Prepaid Cards:

One size does NOT fit all

Store Gift Cards – Payroll Cards – Teen Spending Cards – Travel Cards – Mall Cards – and more...

- Some establish bank accounts. Most do not.
- Some are one-time transitory products that are thrown away when used up. Others allow for reloading and longer term relationships.
- Some are entirely anonymous. Others are imprinted with customer names and can be renewed every 2-3 years
- Some provide cash access at ATMs. Many do not allow for cash redemption.
- Some are pre-denominated in fixed dollar amounts. Others are loaded with value up to the level requested by the purchaser.

Prepaid Cards: Two Distinct Categories

- Closed Loop – “Store Cards”
- Open Loop Branded
 - Purchasing Cards
 - General Purpose Cards (purchasing + ATM access)
 - Corporate, Business, Government Cards

bloomingdale's

LOCATIONS REGISTER MY ACCOUNT ORDER STATUS

MY BROWN BAG: 0 items

apparel for her accessories fragrance home luggage great gifts gift cards shop catalogs register

gift cards

occasion

other

Gift Cards

gift cards

Make sure your gift is the right size, color and style; make it an electronic gift card, the better-than-ever gift certificate.

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The Visa prepaid card for teens

- Powerful tool to learn financial responsibility
- Convenient and flexible
- Safer than cash
- Offers parental control and peace of mind
- Works everywhere Visa debit cards are accepted

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Payroll Cards

- [How They Work](#)
- [Features/Benefits](#)



Payroll Cards are reloadable prepaid debit cards, allowing the employer to place the employees wages on to the card each pay period. The employees in turn can use the cards at any Visa® or MasterCard® location worldwide as well as ATM or POS terminals to access their earnings.

HOW THEY WORK

There are approximately 150 million wage earners in the U.S., significant portions of which are “unbanked”. Check cashing kiosks provide an expensive and inconvenient option for this population.

Payroll Cards are issued to companies who wish to provide a safer, less expensive way for their unbanked employees to cash their payroll. They allow cardholders instant access to cash via established ATM or POS terminals while providing the safer option of utilizing the cards at millions of MasterCard or Visa merchants worldwide.

Additionally, Payroll Cards offer an alternative to printing and mailing paper payroll checks. They are ideal for companies that process payroll, as well as financial institutions providing payroll services to commercial customers, as a value added service to their clients whose employees will consider the Payroll Cards an employee Benefit (all or portions of their paycheck may be transferred to the Payroll Card sponsored by their employer).

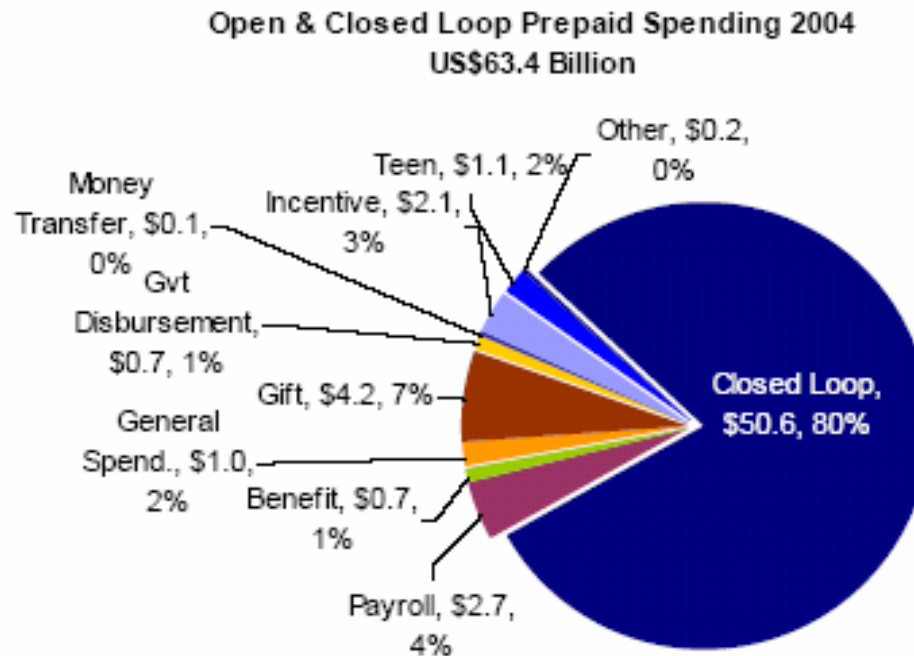
Prepaid Card Sales Are Going Up

- Aite Report* estimates US consumers spent \$63.4 billion on prepaid cards in 2004
 - \$50.6 on Closed Loop cards
 - \$12.8 on Open Loop cards
- Aite Report projects by 2009 a total of \$257 billion will be spent on prepaid cards
 - \$107 billion on Closed Loop cards
 - \$150 billion on Open Loop cards

* “Prepaid Cards: A Market Overview” published by the Aite Group, LLC
September 2005

Open Loop Prepaid Card Sales Growth

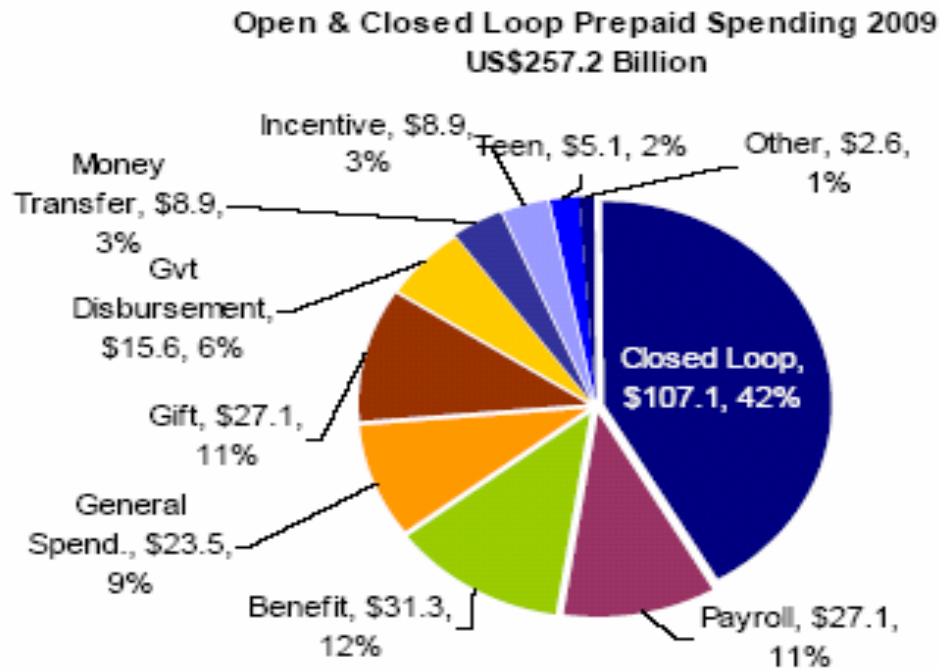
FIGURE 7: ESTIMATED PREPAID CARD SPENDING - 2004



Source: Aite Group

Open Loop Prepaid Card Sales Growth

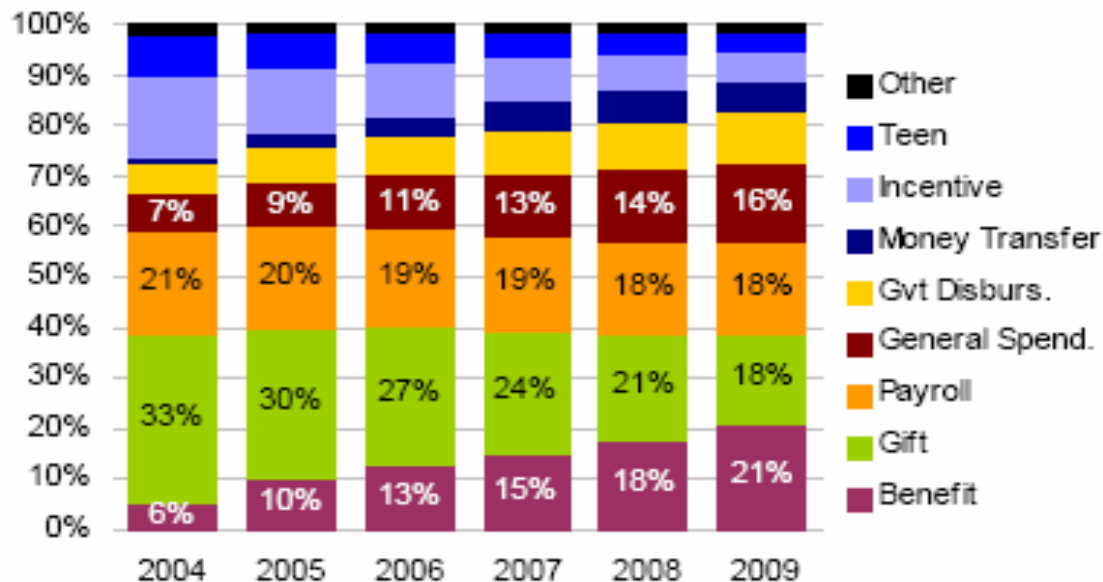
FIGURE 8: PROJECTED PREPAID CARD SPENDING - 2009



Source: Aite Group

Open Loop Prepaid Card Sales Growth

U.S. Open Loop Prepaid Debit Card Transactions
(% of Value)



Source: Aite Group

New Versions of Prepaid Cards

- Gift Cards with cash access
- Reloadable Gift Cards
- General Purpose multi-function cards
 - Purchasing at point of sale
 - Cash access at ATMs
 - Money transfer using second card
 - Bill payment services
- Contactless (radio frequency) cards
- Special purpose – Disaster relief; Health Savings Account (HSA) cards

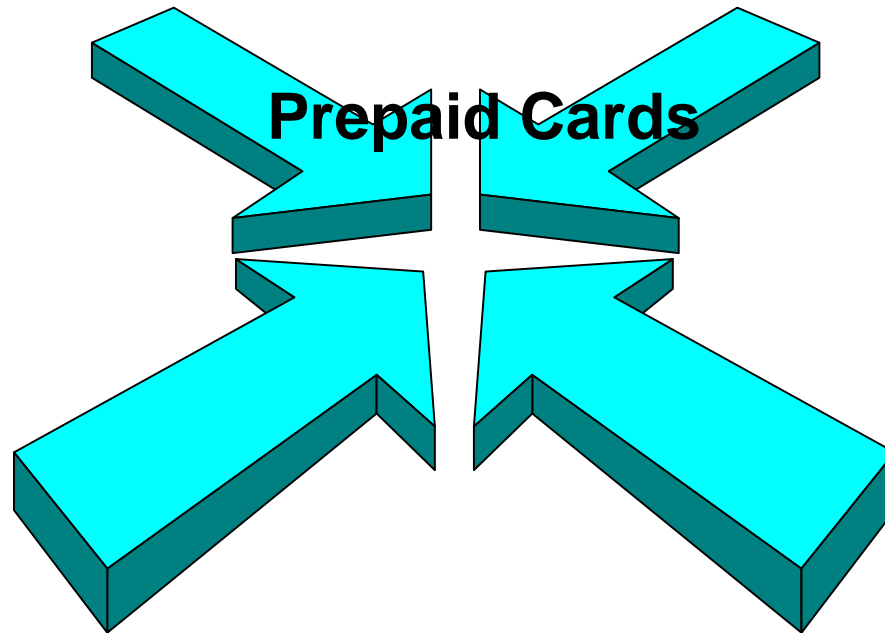
Prepaid Cards in the Media

- **TSYS TAKES THE LEAD IN FORMING A TRADE ASSOCIATION TO PROMOTE OPEN-LOOP PREPAID CARDS (April 2005)**
- **E-COUNT OFFERS PREPAID CARD WITH A LESSON IN FINANCIAL MANAGEMENT FOR TEENS (July 2005)**
- **PREPAID MEDIA ANNOUNCES FIRST ANNUAL PREPAID CARD EXPO - SPONSORS INCLUDE VISA, MASTERCARD, DISCOVER AND AMERICAN EXPRESS (September 2005)**
- **RED CROSS RUNS OUT OF CARDS IN SOME AREAS: The American Red Cross denies news reports that it has halted distribution of MasterCard-branded, prepaid debit cards to those displaced by Hurricane Katrina. "That is not true," a Red Cross spokesperson says. But the cards are in high demand and are not available in some major evacuee centers, particularly in Texas...(September 2005)**
- **NEXT ESTATE RINGS UP DEAL WITH CINGULAR WIRELESS: Next Estate Communications is partnering with Cingular Wireless to offer a new, Cingular-branded prepaid debit card carrying the Visa trademark. (October 2005)**
- **INFORMATIONAL HEARING: The California Assembly Committee on Banking and Finance will hold an informational hearing on pay cards and other stored value cards in the Capitol at 10 AM on Wednesday, October 12, 2005.**

State abandoned property and consumer protection laws

Increased Regulation of *Open System Prepaid Cards*

Federal (and State) AML laws



State money transmitter/ sale of checks licensing laws

Federal banking, data security and consumer protection laws

Regulatory Update:

State Abandoned Property and Consumer Protection laws

- 16 States have passed laws that apply specifically to prepaid cards and/or gift cards
- Currently more than 60 state bills pending in more than 20 states
- Most of these laws limit or prohibit:
 - Expiration Dates
 - “Servicing” or “Dormancy” fees
- Many have specific disclosure requirements
- Many require escheatment of “breakage” to states
- These state laws are not uniform
- Some of these state laws exclude “open system” cards useable at a multiple unrelated establishments. Others do not.

Summary of State Abandoned Property and Consumer Protection laws

States with Consumer Protection or Abandoned Property Laws limiting expiration dates for some or all prepaid cards	States with Consumer Protection Laws or Abandoned Property Laws limiting “service” or “dormancy” fees for some or all prepaid cards	States with Consumer Protection Laws limiting ALL fees for some or all prepaid cards	States with Abandoned Property Laws explicitly applying to some or all prepaid cards	States with Abandoned Property Laws explicitly linking abandoned property to the Card fees, disclosures or expiration dates - for some or all prepaid cards
CALIFORNIA CONNECTICUT GEORGIA HAWAII ILLINOIS LOUISIANA MAINE MARYLAND MASSACHUSETTS MONTANA NEW HAMPSHIRE NEW YORK RHODE ISLAND VIRGINIA WASHINGTON	CALIFORNIA CONNECTICUT DELAWARE GEORGIA HAWAII ILLINOIS LOUISIANA MAINE MARYLAND MASSACHUSETTS MONTANA NEW HAMPSHIRE NEW YORK RHODE ISLAND VIRGINIA WASHINGTON	CONNECTICUT (except up front purchase fees) HAWAII* MASSACHUSETTS* *based upon state regulatory interpretation	ALASKA COLORADO IOWA MAINE NEW HAMPSHIRE TEXAS VIRGINIA	CALIFORNIA IDAHO ILLINOIS MASSACHUSETTS NEW JERSEY NEW YORK NORTH CAROLINA

Regulatory Update:

State Money Transmitter Licensing Laws

- At least 17 states have amended their money transmitter licensing laws specifically to require issuers of prepaid cards (other than single-retailer gift cards) to get a license under state money transmitter laws.
 - Connecticut, District of Columbia, Illinois, Iowa, Louisiana, Maryland, Minnesota, Mississippi, North Carolina, North Dakota, Oregon, Texas, Vermont, Virginia, West Virginia, Wyoming, Washington
- Most of these laws appear to apply to issuers or sellers of any prepaid card useable at multiple unaffiliated retailers
- Some states have held that their laws cover issuers or sellers of open system prepaid cards even if they have not amended their laws to cover them – *depending on the product*.
 - Arizona, Colorado, Delaware, Florida, Maine, Nebraska, New York, Ohio, Pennsylvania, Rhode Island, Tennessee

Regulatory Update:

State Money Transmitter Licensing Laws

- Not all Prepaid Card issuers or sellers are covered by these laws. Excluded are :
 - Issuers or sellers of proprietary or “store gift cards”
 - Issuers or sellers that are banks or other regulated depository institutions *though some may require licensing for state chartered banks*
 - Issuers or sellers that are “agents” of licensed money transmitters or (*in most instances*) regulated depository institutions
- Some states are more concerned about “cash accessible” products versus gift cards useable solely for purchasing goods/services.
- “Money transfer” products generally require licensing.

BOTTOM LINE: Check with your state regulator!

Regulatory Update:

REG E – Electronic Funds Transfer Act

- 2004: New proposed formal extension of Reg E to “Payroll Cards” – defined as:
 - Established directly or indirectly by an employer for distribution of compensation on a recurring basis
 - Excludes one-time transfer of salary-related payments, like bonuses or travel reimbursement (unless transferred to the same payroll “account”)
- Comment period ended November 19, 2004
- Concern raised by industry on periodic statement requirements and by consumer groups regarding the narrow definition of “payroll card”

Hot Regulatory Issue: Deposit-Taking?

- A small number of states have indicated that selling or loading open system, reloadable, prepaid cards (especially those with ATM cash access) is the equivalent of “deposit-taking”
- A few have suggested that such activity may constitute “branch banking” by the “issuing” bank
- A few have suggested that retailers cannot do this – even if the cards are issued by a bank – without violating state banking laws

Hot Regulatory Issue: Preemption

- Does the Doctrine of Federal Preemption apply to Prepaid Cards issued by national banks and federally chartered thrifts?
- Simon Gift Card litigation has raised doubts
 - 4 State AGs sued Simon Property Group for violating state gift card laws
 - OCC letter – released January 2005 – indicated no substantive preemption of *Simon's* fees
- OTS and the *State Farm* decision preempting state licensing laws for “Agents” (Mortgage)
- Status uncertain - Preemption issue still being reviewed by OCC and OTS

Hot Regulatory Issue: Federal Deposit Insurance

- 1996 - General Counsel's Opinion No 8
- 2003 - Advisory Opinion
- 2004 FDIC proposed rule - Comment period ended July 2004
- 2005 FDIC proposed rule - Comment period ended - November 7, 2005

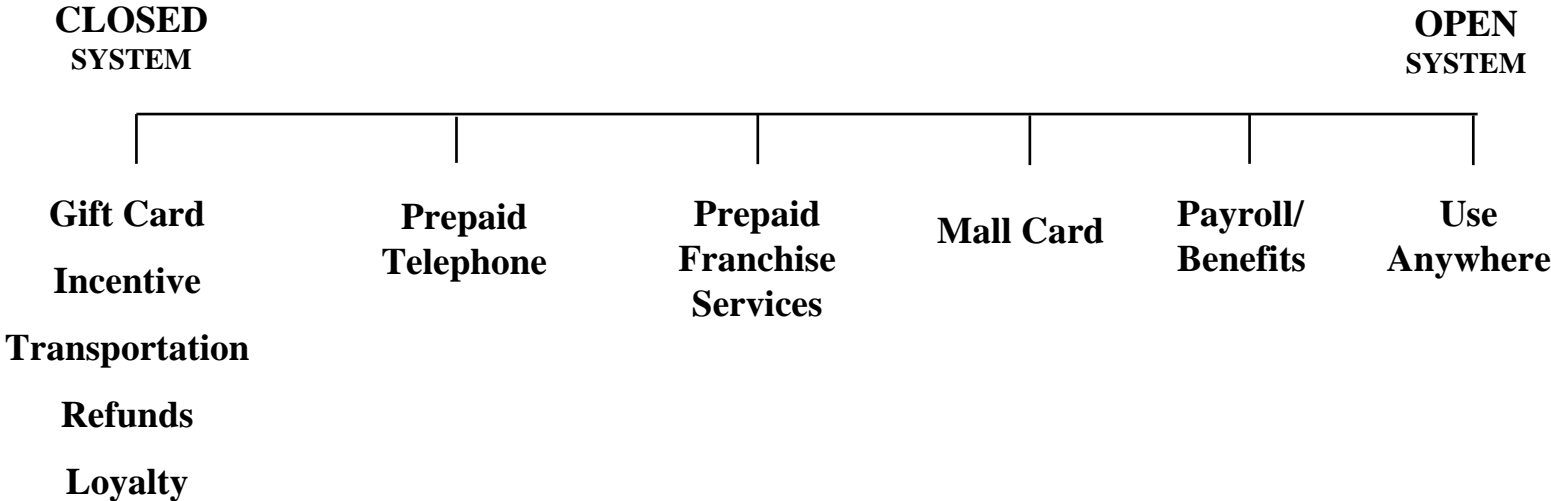
Regulatory Update: Anti-Money Laundering and OFAC

- Bank Secrecy Act and implementing regulations
- FinCEN Guidance re: MSBs
- New BSA/AML Examination Manual
- Office of Foreign Assets Control (OFAC) “guidance”

Money Laundering and Terrorist Financing Risks: Key Issues

- **Are stored value/prepaid cards being used to launder money or finance terrorism?**
- **How are they being used?**
- **Do the issuers and sellers face any risks from such use?**
- **What are those risks?**
- **What factors affect these risks?**
- **How can these risks be minimized?**
- **What steps can issuers, sellers and other program participants take?**

Types of Programs



Analyzing the Risks

- **What type of card/program?**
- **What is the role of the bank in the program?**
- **Who are the other program participants?**
- **How are the cards distributed?**
- **How are the cards “loaded” with value?**
- **Are the cards reloadable?**
- **Who has the assigned AML compliance responsibility?**

Money Laundering Myths

- 1. There is no money laundering risk in a closed system**
- 2. Money laundering risk does not exist in a payroll card system**
- 3. Money laundering risks are eliminated by “load” limits**
- 4. Money laundering risk can be controlled by POS “spend” limits**
- 5. Money laundering risk is low because of ATM withdrawal limits**

Money Laundering Myths

6. **Money launderers can be denied cards with a good customer identification program (CIP)**
7. **Money laundering risk is limited if a bank issues both the card and the stored value associated with the card**
8. **Money laundering risk does not exist if a bank does not use a third party to market the cards**
9. **There are no money laundering risks if a bank does not offer load and re-load capability through third parties**
10. **The card processor is managing the money laundering risks**

Consumer Acceptance

- **Speed**
- **Anonymity**
- **Security**
- **Transfer functionality**
- **Convenience**
- **Access to financial system**
- **Cost effective delivery system**

“Bad Guy” Use

- **Speed**
- **Anonymity**
- **Security**
- **Transfer functionality**
- **Convenience**
- **Access to financial system**
- **Cost effective delivery system**

The “Players”

- **Issuers**
 - “Card”
 - “Stored Value”
- **Card Processors**
- **Card Systems**
 - POS
 - ATM
- **Sales / Distribution Channels**

Load & Re-Load Options

How

- In-person
- Mail
- ATM
- Telephone
- Internet

What

- Cash
- Check/ Money Order/
Bank Draft
- ACH Transfer
- Wire
- Credit Card
- Debit Card
- Stored Value Card

“Spend” Options

How

- **Cardholder Present**
 - In Person
 - ATM
- **Cardholder Not Present**
 - Telephone
 - Internet

What

- **Cash Withdrawals**
- **Merchant Payments**
- **Funds Movement**

Funds Transfer Capability

- **By Design**
 - One “Account” / Two (or more) Cards
 - Cards Used in Different Countries
- **By Use**
 - Multiple “Accounts” / One Person
 - Cards Used in Different Countries

18 U.S.C. § 1960

- **Prohibits**

- Engaging in a MTB without the required state licenses
- Operating a MTB without registering as an MSB
- Transmitting funds known to be derived from criminal activity or intended to be used to promote or support an unlawful purpose (e.g., unlicensed MSB)

- **Penalties for violation**

Criminal Use

Jeff Ross

Senior Advisor

Office of Terrorism and Financial Intelligence

U.S. Department of the Treasury

Tom Lasich

Federal Law Enforcement Training Center

U.S. Department of Homeland Security

Risky Business?

Low	Medium	High
<p data-bbox="205 531 491 568">Fixed Amount</p> <p data-bbox="194 614 502 651">One-Time Load</p> <p data-bbox="194 696 502 733">Bank Customer</p> <p data-bbox="129 796 567 888">Full Identification and Verification</p> <p data-bbox="247 931 449 968">No Holder</p> <p data-bbox="110 1013 586 1105">Funds from Customer's Account</p>	<p data-bbox="849 531 1100 568">Some Limits</p> <p data-bbox="811 614 1138 651">Controlled Load</p> <p data-bbox="860 1013 1089 1051">Credit Card</p>	<p data-bbox="1397 531 1766 568">Unlimited Amount</p> <p data-bbox="1412 614 1751 651">Fully Reloadable</p> <p data-bbox="1325 696 1839 733">No Relationship to Issuer</p> <p data-bbox="1386 788 1778 879">No Identification or Verification</p> <p data-bbox="1386 931 1778 968">Anonymous Holder</p> <p data-bbox="1527 1013 1633 1051">Cash</p>

Where Are We Now?

- **New paradigm**
- **Understand the roles**
- **Understand the risks**
- **CIP is not enough**
- **Initial due diligence is essential**
- **Robust monitoring is critical**
- **Do not forget to ask: are licenses required?**

What Does the AML Program Need?

- **Strong customer due diligence program**
 - Understand the market for the card
- **Unusual activity monitoring**
 - Understand the channels
 - Understand usage
 - Understand data collected
- **Partner due diligence**
 - Understand role and exposure in program
 - Understand AML/OFAC compliance efforts

ASSUME NOTHING

For further information contact:

CAROL R. VAN CLEEF

Partner

202-508-6112

carol.vancleef@bryancave.com

JUDITH RINEARSON

Partner

212-541-1135

judith.rinearson@bryancave.com

PATRICE MOTZ

Of Counsel

202-508-6121

patrice.motz@bryancave.com

MAUREEN SANDERS

Regulatory Consultant

202-508-6065

maureen.sanders@bryancave.com

BRYAN CAVE LLP

700 Thirteenth Street, N.W.

Washington, DC 20005

Facsimile 202-508-6200