

Prepaid Card Industry Dynamics & Money Laundering Risks Associated with Prepaid Cards

September 4, 2009

Philip Keitel

Industry Specialist, Payment Cards Center

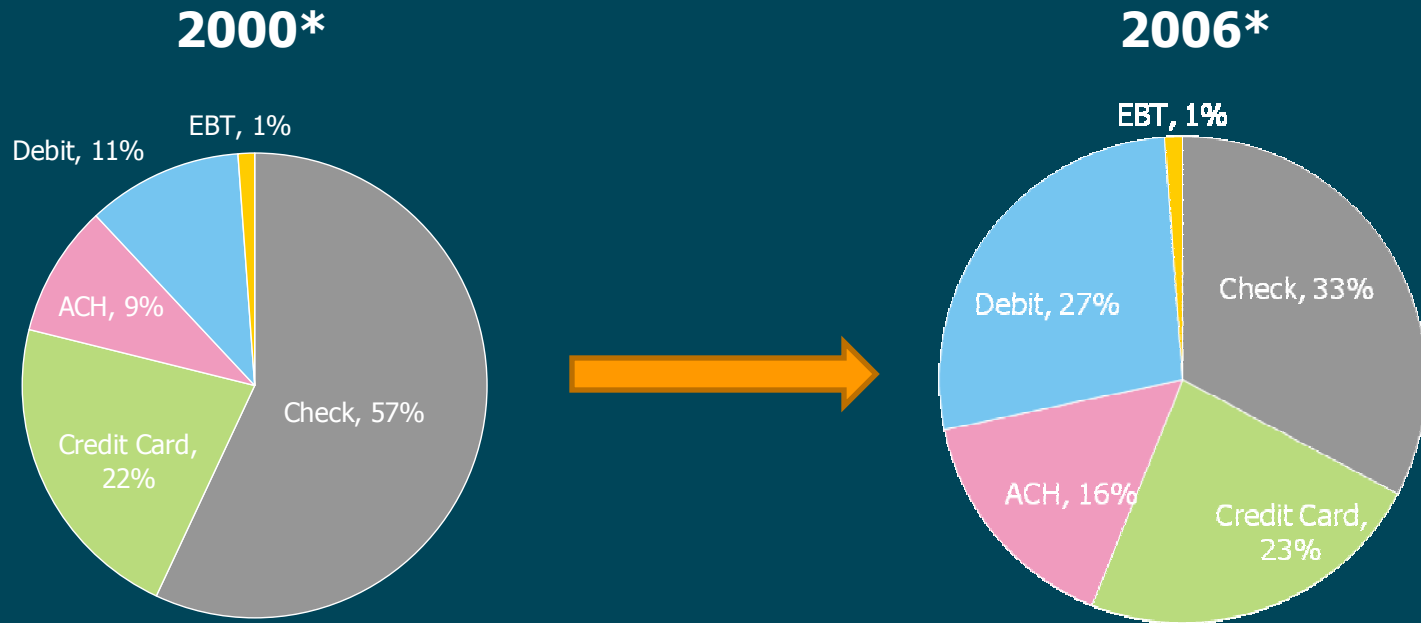


FEDERAL RESERVE BANK
OF PHILADELPHIA

**The views expressed here are those of the author and not necessarily those of the Federal Reserve Bank of Philadelphia or the Federal Reserve System. In addition, mention of various government agencies' communications or positions in this presentation does not constitute an endorsement or criticism of those agencies, materials, or positions.*

Migration to Electronic Payments

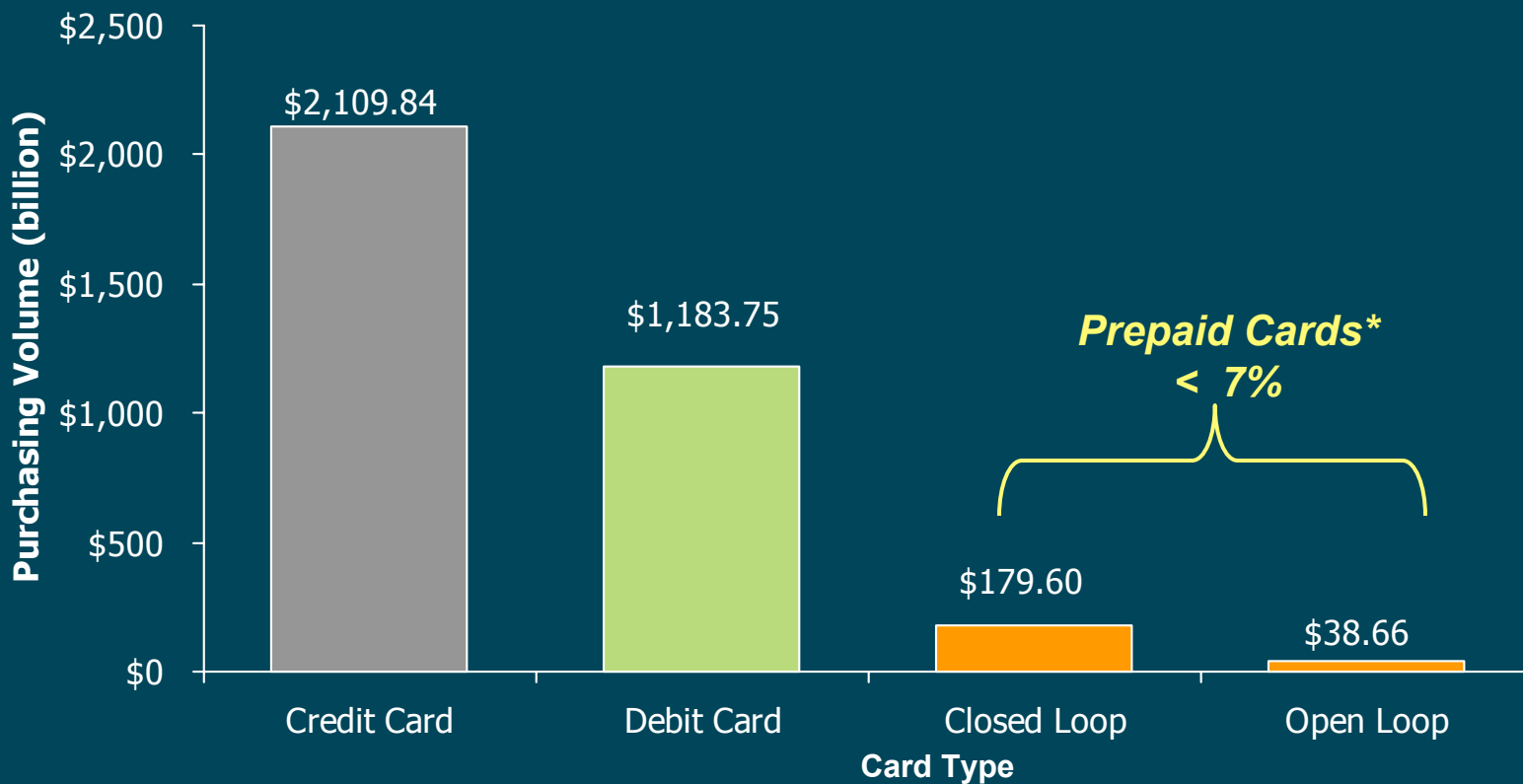
Distribution of Noncash Consumer Payments



Source: Federal Reserve Payments Studies 2001 & 2007



Payment Card Market Share 2007



Source: The Nilson Report

*Prepaid card data source: Mercator Advisory Group



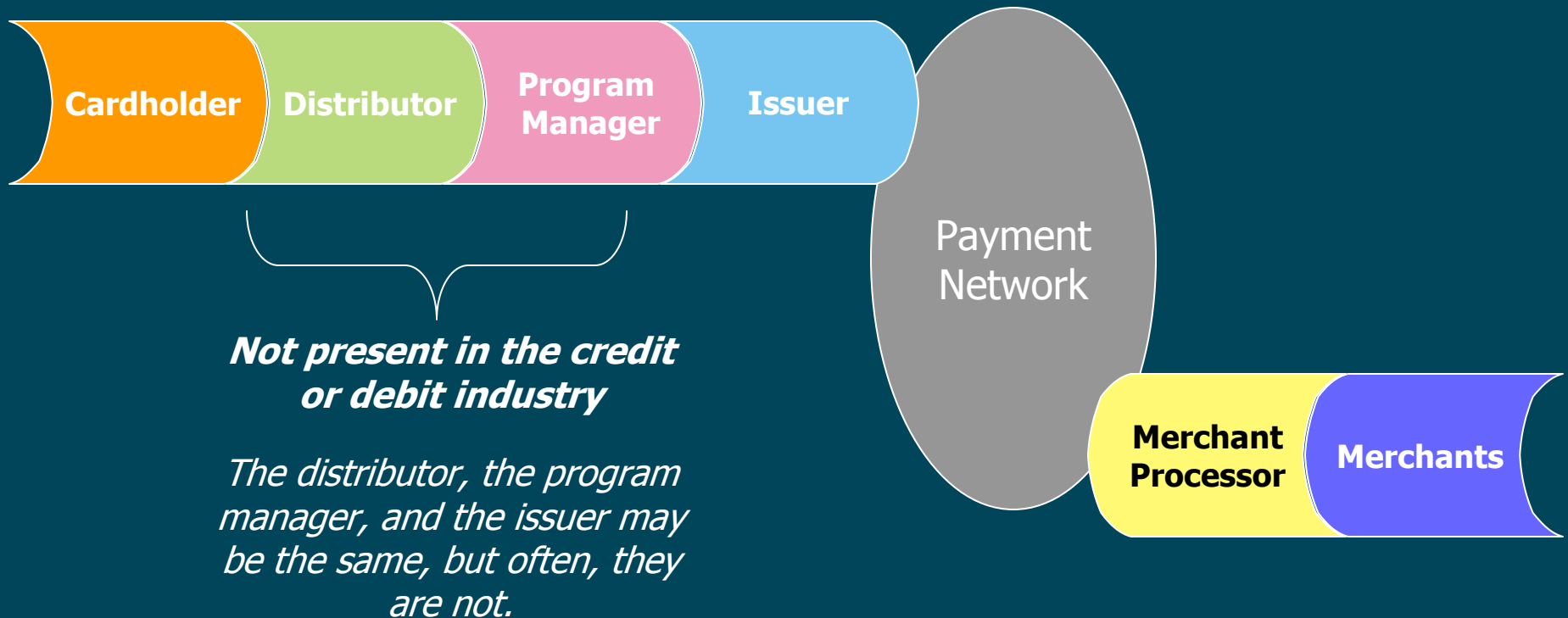
Prepaid Card Applications

- **Cash Access**
 - Money Remittance/P2P
 - Travel
 - Open Gift
- **Business Expenses**
 - Business Travel
 - Events & Meetings
 - Employee/Partner Incentives
 - Relocation Card
 - Purchasing
- **Digital Content**
 - Digital Media (songs, etc.)
 - Games
 - Ring Tones
- **Gift Cards**
 - Closed-Loop/In-Store Sales
 - Open-Loop
- **Government Spending Programs**
 - Social Security
 - Food Stamps
 - Unemployment
- **Insurance Benefits**
- **Payroll & Employee Benefits**
 - Payroll
 - HSA
 - Commuter Benefits
- **Mobile Phone Applications**
- **Petroleum**
- **Utilities**
- **Telecommunications**
 - Prepaid Mobile
 - Prepaid Long Distance
- **Online Gaming**
- **Online Virtual Currency**
- **Collegiate**
 - Campus Programs

Source: Mercator Advisory Group



Prepaid Cards



Prepaid Cards

Examples of nonbank distributors and/or program managers



Travel Cards/Remittance

Western Union

Travelex

Moneygram

AAA

FSA/HSA Cards

United Healthcare

Evolution Benefits

Tax Rebate Cards

H&R Block

Jackson Hewitt

Gift Cards

Simon Property Group

Insurance/Disaster Cards

Amica

American Red Cross

Incentive Cards

Maritz (+ AMEX)

General Prepaid Dist., Load, etc.

InComm

Green Dot

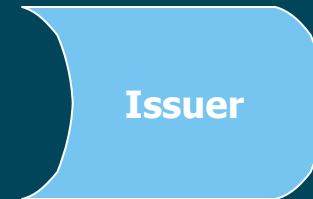
Blackhawk Network (Safeway, Inc.)

Payroll Cards

Paychex

ADP

Some of the leading bank issuers of prepaid cards



Bank of America

MetaBank

JPMorgan Chase

Comerica Bank

The Bankcorp Bank PSG

U.S. Bank

Wells Fargo

Citibank

Citizens Bank

Commerce Bank Mo.

Regions Bank

HSBC

SunTrust

USAA

M&T Bank

KeyBank

Navy FCU

PDNB



Known Money Laundering Risks Posed by Certain Prepaid Programs/Program Features

Risk-based compliance:

- ✓ Risks related to particular prepaid program characteristics that have been identified in reports by regulators, legislators, & law enforcement
- ✓ Risks that can be derived from specific instances in which criminals have used prepaid cards



Money Laundering Risks & Prepaid Card Programs

- Members of Congress
 - “Cash earned from U.S. drug sales, the lifeblood of the cartels, is increasingly smuggled back to Mexico in stored value cards. A single card can hold thousands of dollars, is far less conspicuous than bundled cash, and does not, as a matter of law, have to be declared at the border. Unfortunately, these cards are not considered legal monetary instruments, and border officials have little authority to police them.”



Money Laundering Risks & Prepaid Card Programs

- Terry Goddard, AZ Attorney General
 - Prepaid cards are a “passport for cash.”
 - “[T]his is an international problem..there are huge amounts of money being electronically transferred across borders throughout the world.”
 - These cards are “often issued by offshore banks and allow large sums of money to be moved throughout the world.”
 - And “since they’re not considered monetary instruments, they can be taken across the border and you don’t break any laws.”



Money Laundering Risks & Prepaid Card Programs

- World Bank
 - Preventing Money Laundering and Terrorist Financing: A Practical Guide for Bank Supervisors (2009)
 - Prepaid cards “may pose a higher risk of money laundering or terrorist financing at one bank than at another. A higher degree of risk may exist in cases where, for example, a bank’s products and services allow the customer to be treated anonymously, or involve international transactions, or involve high volumes of currency (or currency equivalent) transactions.”



Money Laundering Risks & Prepaid Card Programs

- U.S. Treasury, DOJ, Homeland Security, Fed Board of Governors, & USPS
 - Money Laundering Threat Assessment (1997; 2005) & National Money Laundering Strategy (2007)
 - Cross-border features
 - Portability
 - Anonymity/little identity verification – many programs without CIP, no rigorous monitoring of activity
 - ATM functionality



Money Laundering Risks & Prepaid Card Programs

- Justice Dept's National Drug Intelligence Center
 - 2007 National Drug Threat Assessment
 - Usable anywhere
 - ATM functionality
 - Obtained/used without fear of documentation
 - 2006 Prepaid Stored-Value Cards: A Potential Alternative to Traditional Money Laundering Methods
 - "Prepaid cards provide an ideal money laundering instrument to **anonymously** move monies associated with all types of illicit activity... ."
 - Portability
 - Inability to seize cards for failure to report



Money Laundering Risks & Prepaid Card Programs

- Financial Action Task Force on Money Laundering
 - Organized originally by the G-7 countries in 1989, now includes approx. 33 member countries
 - 2006 Report on New Payment Methods
 - Examines money laundering techniques and trends and produces risk profiles:
 - Cross-border transfers
 - Off-shore card issuers
 - ATM functionality
 - Smart cards identified as a potential money laundering instrument



Money Laundering Risks & Prepaid Cards – Cases

- Horacio Munar & AAA Global Currency Cards (2002-05)
 - U.S. District Court, Northern District of Ohio
 - More than \$5.5 million involved; used cards at ATMs in Argentina and Uruguay



Money Laundering Risks & Prepaid Cards – Cases

- Robert Arbuckle & Moola Zoola (2006)
 - U.S. District Court, Eastern District of Texas
 - Moved stolen funds to Russia using Moola Zoola brand prepaid ATM cards
 - “Stored value cards are a new area that really has no regulation and is being used to launder money all over the world.” – Asst. U.S. Atty. Ernest Gonzalez



Money Laundering Risks & Prepaid Cards – Cases

- Sallie Wamsley-Saxon (2001-07)
 - Prepaid cards used to move funds associated with the operation of a prostitution ring (Hush Hush).
 - Purely domestic. **Anonymity, reloadability** targeted.
 - Prepaid card account balances were held in one of the defendant's names because personal and immediate use of funds was desired.
 - Dispensing wages on prepaid cards the Saxons mimicked a behavior that is common among many of today's largest companies—using prepaid cards as a means of electronic payroll disbursement.



Money Laundering Risks & Prepaid Cards – Cases

- Behcet Alkis (2003-07)
 - Used proceeds from criminal activity to purchase a number of gift cards and prepaid debit cards
 - Frequently purchased \$100 cards
 - Leveraged credit card accounts opened fraudulently via the use of false identities
 - Used his business (mall kiosks) like a false-merchant purchaser of gift and prepaid debit card lots



Money Laundering Risks & Prepaid Cards – Cases

- DMG/Murcia Guzman (2009)
 - Defendants set up a company (DMG) that sold closed-loop prepaid cards to consumers who could then use those cards to purchase goods at retail businesses and, as the indictment implicates, the company was used to launder funds.
 - Narcotics proceeds funneled through DMG by “using the Colombian Black Market Peso Exchange ... to launder illicitly-obtained dollars in the United States, in exchange for pesos taken in for ‘legitimate’ purchases in Colombia...”



Money Laundering Risks & Prepaid Cards – Cases

- Anecdotal Reports
 - Gift cards shipped abroad
 - Police raids find large numbers of cards
 - Border police discover boxes of cards



Recent Events

- FinCEN Notice of Proposed Rulemaking (May 2009)
 - Proposal to revise the MSB definition; should \$1,000 MSB definition-related trigger be raised or lowered?
- Credit CARD Act of 2009 (May 2009) – Title V, Section 503
 - February 22, 2010
 - Redefine “sellers,” “issuers,” “redeemers”?
 - Classify/define prepaid instruments as “monetary instruments”?



Recent Events

- Money Services Business Act (June 2009) – Rep. Carolyn Maloney; act passed House by voice vote 2008; now being revived
 - Act eliminates banks' monitoring requirements associated with accounts held by MSBs
 - Rep. Luis Gutierrez also has a bill in the works that concerns money remittance fees and regulators
 - Banco Popular announced in May that it would terminate MSB accts



Contact Information

Philip Keitel

Industry Specialist, Payment Cards Center

Federal Reserve Bank of Philadelphia

Ten Independence Mall

Philadelphia, PA 19106-1574

- ✓ Website: www.philadelphiafed.org/payment-cards-center
- ✓ Phone: (215) 574-6210
- ✓ Fax: (215) 574-7101
- ✓ E-mail: philip.keitel@phil.frb.org

