

2009

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Prepaid Cards – Federal Law Issues and Developments

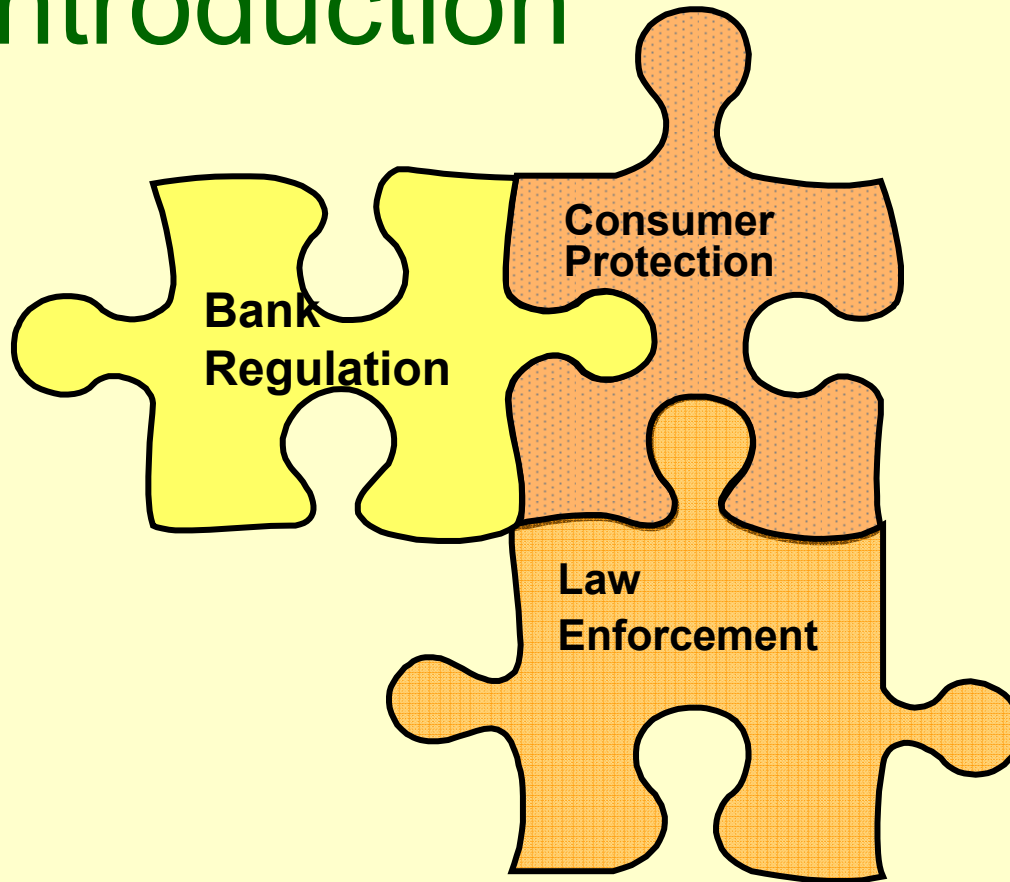
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Introduction



Bank Regulation

- Bank Liabilities
- Federal Deposit Insurance
- Financial Industry Regulatory Reform (Proposed)
- Federal Preemption
- CRA



Bank Regulation – Who has the obligation to the Cardholder? (General Purpose Network Branded Open – Loop)

- Bank – Issued / Bank Obligation
 - Card / Network Requirements
 - Funds on Account for Future W/D
- Traditional Money Transfer
 - Obligation from MT to Sender until Paid to Recipient
 - Obligation backed by Permissible Investments
- Prepaid Card Loads
 - Obligation of Bank from Point of Sale
 - Obligation backed by Bank Assets and Capital

Bank Regulation – What if the Retailer or some Intermediary in the Flow of Funds fails to Remit to the Bank?
(General Purpose Network Branded Open – Loop)

- Bank – Issued / Bank Obligation
 - Payment to Retailer effectively Payment to Bank
 - Bank cannot turn off Card
- Remittance to Bank
 - Commercial Arrangement
 - agent / payment processor liable to bank

Bank Regulation – What if the bank holding the money fails?

- Open loop prepaid funds are treated as “deposits” to extent placed at FDIC-insured institution (New FDIC General Counsel Opinion No. 8 (Nov. 13, 2008) addressing “bank cards” (open-loop) and not “merchant cards” (closed loop))
- FDIC insurance limit \$250,000 / Unlimited for qualifying non-interest bearing transaction accounts at banks that haven’t opted out, ext to 6/30/10
- “Pass-through” insurance for individual owners (acct title & records of identity and interest & deposit owned by cardholder)

Bank Regulation – How will Financial Regulatory Reform Impact Prepaid Card Programs? (Obama White Paper)

- Proposal to create National Bank Supervisor (merging OTS & OCC)
- Increased capital adequacy standards for banks
 - Including composition of capital, scope of risk coverage, relative risk weights, and calibration
- Tighter affiliate transaction restrictions for banks
 - Potential impact on banks that market product through affiliates
- Raise international regulatory standards and improve international cooperation
 - likely result in heightened scrutiny by US and foreign banking regulators with respect to international banking operations, especially relating to capital adequacy of banks and anti-money laundering protections
- Increase consumer protection standards and oversight (CFPA)
 - “The CFPA’s strong rules would serve as a floor, not a ceiling. The states should have the ability to adopt and enforce stricter laws for institutions.”

Bank Regulation – What does the Obama Memo and the *Cuomo* Case mean for Federal Preemption

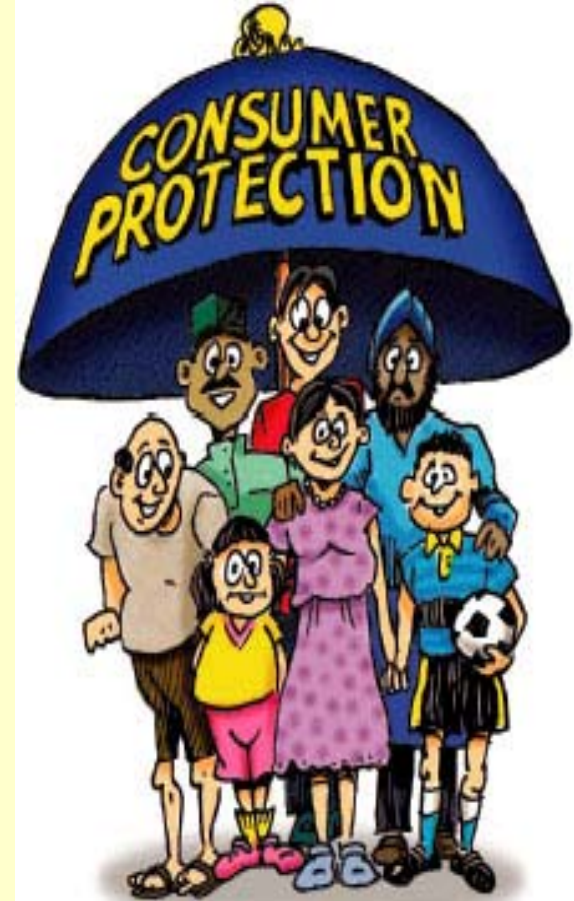
- Doctrine of Federal Preemption of State Laws
 - Federal depository institutions
 - Where state law conflicts with powers granted/activities permitted by Federal law, state law is preempted
 - States often challenge preemption based upon their desire to provide consumer protection to their citizens
- 2009 Developments
 - President Obama Issues Federal Preemption Memo (May 20, 2009)
 - “[P]reemption of State law by executive departments and agencies should be undertaken only with full consideration of the legitimate prerogatives of the States and with a sufficient legal basis for preemption.”
 - *Cuomo v. Clearing House Association LLC* (June 29, 2009)
 - NBA – national banks not subject to state’s “visitorial” powers
 - OCC – defined “visitorial” powers to include “enforcement” (*i.e.*, that a state may not enforce its valid, non-preempted laws against a national bank)
 - *Chevron v. National Resources Defense Council* – Courts defer to an agency’s *reasonable* interpretation of a statute it is charged with administering.
 - Comptroller’s regulation purporting to pre-empt state law enforcement is not a reasonable interpretation of the NBA.

Bank Regulation – Can a bank get CRA credit for participating in a prepaid card program?

- Encourages banks to meet credit needs of entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of bank
- Payroll cards and remittance services provided through general prepaid or payroll cards may be viewed as positive factors in a bank's CRA assessment

Consumer Protection

- Electronic Fund Transfer Act & Regulation E
- Credit CARD Act of 2009
- Consumer Financial Protection Agency Act of 2009 (Proposed)
- Other



Consumer Protection - Does EFTA and Regulation E apply to Prepaid Cards?

- Prescribes disclosures, limits loss, includes error resolution procedures, for **consumer asset accts**
- Reg. E expressly includes “payroll cards”
 - Rulemaking did not extend coverage to other prepaid cards
 - Industry practices re: general purpose reloadable cards
 - Credit CARD Act amends EFTA to include gift cards, effective August 2010
- Proposal to amend Reg. E – overdrafts fees (12/18/08)
 - 2 alternative approaches “opt-in” vs. “opt-out”

Consumer Protection – What does the Credit CARD Act mean for Prepaid?

- Gift card related sections amends EFTA
- Gift certificates, store gift cards, and general use prepaid cards (but not cards used solely for telephone purposes or cards that are reloadable and not labeled or marketed as gift cards)
- Excludes “loyalty, reward or promotional gift card[s]”
- No service fees < 12 mos. Inactivity (initial fee okay) (after 12 mos., service fees limited to 1 per mos.)
- No expiration < 5 yrs. after issuance or last load (whichever later)
- Requires certain disclosures (clear and conspicuous for fees and exp)
- Provides FRB with authority to regulate fees
- Requires FRB to determine extent EFTA and Reg E should apply
- Effective Aug 2010, proposed regs expected early fall 09, final regs required Feb 2010

Consumer Protection – What does the Consumer Financial Protection Agency (CFPA) Act (Proposed) mean for Prepaid?

- Would establish Consumer Financial Protection Agency (“CFPA”)
- Would authorize CFPA to examine, write and enforce regulations against “covered persons” including money transmitters and stored value sellers to:
 - prevent unfair, deceptive, or abusive acts or practices
 - ensure appropriate communications, disclosures, and sales practices
 - prohibit or limit the use of mandatory arbitration clauses in consumer agreements
- Preserves state licensing regime of money transmitters
- Encourages states to prescribe “operational standards” to deter and detect unfair, deceptive, abusive, fraudulent or illegal transactions
- Provides CFPA with authority to enforce operational standards established by states
- Clarifies state law preemption standards for federally chartered banks
- Banking industry concern: Inherent conflict in separating consumer protection responsibilities from “safety and soundness” responsibilities

Consumer Protection – What are some other Federal consumer protection considerations for Prepaid?

- Privacy and Data Security
 - GLBA applies to “financial institutions” broadly defined to include MTs
 - Consider applicability of notice and opt out requirements
- Truth in Savings / Reg. DD? Applies to an “Account” defined as a “deposit account at a depository institution that is held by or offered to a consumer.”
 - Most prepaid products are structured in a manner that should not be viewed as involving an “account” under Reg. DD
- Federal Trade Commission
 - Works to prevent fraudulent, unfair and deceptive business practices
 - Recent examples of enforcement actions include prepaid phone products not delivering the minutes they promised, and deceptive online marketing of debit cards.

Law Enforcement

- 18 USC §1960
- BSA / AML Requirements
- OFAC
- Stored Value as Monetary Instruments
- Unlawful Internet Gambling



Law Enforcement – Is failing to obtain a MT license required under state law a federal crime?

- “Whoever knowingly conducts, controls, manages, supervises, directs, or owns all or part of an unlicensed money transmitting business, shall be fined in accordance with this title or imprisoned not more than 5 years, or both.” 18 USC 1960
- “unlawful criminal activity”
 - operating without a required state money transmitter license,
 - failing to comply with MSB registration requirements, or
 - transfers involving funds derived from a criminal offense or to support unlawful activity

Law Enforcement – What BSA / AML Requirements apply to Prepaid?

- AML compliance program (risk-based) required for:
 - banks
 - required to file SARs > \$5,000
 - money transmitters
 - required to register as MSB
 - required to file SARs > \$2,000
 - any issuer, seller or redeemer of “stored value” > \$1,000 to a person in a day in one or more transactions
 - not required to register as MSB
 - not required to file SARs, but may do so voluntarily
- CTRs required for all cash transactions > \$10,000
- CIP? Issuers routinely subject individuals purchasing reloadable, cash-accessible network branded prepaid cards to CIP

Law Enforcement – BSA / AML Requirements – continued

- Recent Developments
 - FIN-2008-R005
 - Whether certain reloadable card operations are MSBs
 - FIN-2008-R006
 - Whether an authorized agent for receipt of utility payments is a money transmitter
 - FIN-2009-R001
 - Whether certain operations of a service provider to prepaid stored value program participants is an MSB
 - FinCEN proposal to amend definition of MSB (Fed. Reg. 5/12/09)
 - Proposed changes to clarify entities regulated as MSBs
 - Seeks to ensure that foreign entities offering services in the U.S. are covered as MSBs (irrespective of physical presence)
 - Solicits comments on stored value to assist FinCEN with a future rulemaking proposing a revised definition of stored value and related regulations

Law Enforcement – What about OFAC?

- Separate and distinct from BSA requirements, which are enforced by FinCEN
- OFAC administers and enforces economic and trade sanctions against targeted foreign countries and Specially Designated Nationals
- All U.S. persons must comply with OFAC regulations
- Risk-based compliance program
- Economic Sanctions Enforcement Guidelines

Law Enforcement - Stored Value as Monetary Instrument

- NDIC - 2009 National Drug Threat Assessment; Emerging Threat Subcommittee; McCain, Lieberman - drug trade and Mexico
- Section 503 of the Credit CARD Act: By February 16, 2010, Treasury must issue final BSA regulations related to stored value
- The regulations may include reporting exporting and importing of stored value under 31 USC 5316
 - If deemed monetary instruments, all persons carrying prepaid cards > \$10,000 must declare at US borders crossings

Law Enforcement – Does the Unlawful Internet Gambling Enforcement Act of 2006 apply to Prepaid?

- Unlawful Internet Gambling Enforcement Act of 2006
 - Prohibits any person engaged in business of wagering from knowingly accepting payments in connection with participation of another person in “Unlawful Internet Gambling” (*i.e.*, placing or receiving a wager using Internet where wager is unlawful under applicable federal or state law in location where wager is initiated or received)
- Treasury & Federal Reserve issue joint final rule (31 CFR Part 132) to implement the Act (effective 1/19/09; mandatory compliance 12/1/09)
 - Policies and procedures required for participants in “designated payment systems” (including card systems and certain money transmitting businesses)
 - Provides non-exclusive examples of such policies and procedures
 - Non-exclusive examples contemplate that operator, card issuer, third-party processor and merchant acquirers will have policies and procedures
 - Retailers that sell pre-paid gift cards or stored value products of other issuers are not participants in a designated payment system as defined by Rule

Questions and Discussion

Thank You!

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