

To the Point!



Prepaid Card Proposed Rule: How Does It Apply to Your Card Programs?

The Consumer Financial Protection Bureau (“CFPB”) has issued its 800+ page proposed rule (with commentary) on prepaid cards (“*Proposed Rule*”). The Proposed Rule is intended to address a number of public policy concerns identified by the CFPB regarding prepaid card program terms and the usage of prepaid cards by consumers as a substitute for traditional checking accounts. The Proposed Rule amends both Regulation E and Regulation Z and establishes new substantive limits on products and new disclosure requirements, and extends consumer protections including error resolution requirements and limits on liability for unauthorized transfers to certain card programs.

The CFPB first released its advance notice of proposed rulemaking on general purpose reloadable prepaid cards in May 2012 (“ANPR”), subsequently held town hall meetings on prepaid cards, started accepting complaints on prepaid cards in July 2014 and released a study on prepaid account agreements in November 2014. On November 13, 2014, two and a half years after the release of the ANPR, the CFPB issued this Proposed Rule.

You now have 90 days to comment on the Proposed Rule following its publication in the Federal Register. The CFPB has proposed an effective date for the final rule nine months after publication of the final rule (with exceptions for certain disclosure requirements for marketing material printed before the effective date). The CFPB appears committed to moving quickly to have a final rule in place. This means that card issuers should begin to analyze the Proposed Rule to enable them to prepare for the new requirements before they have been finalized.

The application of the Proposed Rule to card programs and the requirements of the Proposed Rule vary based on card program attributes and whether or not the consumer has registered his or her account. In order to analyze how the proposal may affect your institution, you must review your card programs and determine which of the Proposed Rule’s requirements, if any, apply.

Card Programs Subject to Regulation E Requirements

Covered Accounts; Exclusions. Under the Proposed Rule, a “prepaid account” is defined under Regulation E as having each of the following characteristics:

- Established primarily for personal, family or household purposes;
- Issued for a prepaid amount or is capable of being loaded with funds (by the consumer or a third party);
- Used to access funds at multiple unaffiliated merchants, at ATMs or for “person-to-person transfers”; and
- Includes both programs with physical cards and programs where a card is not required to access funds loaded onto a consumer’s account.

A prepaid account includes government benefits accounts and payroll card accounts (with recurring deposits), revising the existing Regulation E requirements that currently apply to these types of accounts. University cards (such as for the disbursement of student loan proceeds) and insurance cards (such as for the disbursement of worker’s compensation benefits) are also subject to Regulation E if the other criteria in the definition of “covered accounts” are met.

A prepaid account will exclude a digital wallet if it is used as a pass-through device that stores only payment credentials for other accounts to access funds. If, however, funds can be stored on the digital wallet by the digital wallet provider and then

transferred to the ultimate payee, the digital wallet *would* be a prepaid account subject to Regulation E, provided the other criteria of the definition are met.

A prepaid account excludes gift cards and gift certificates; store gift cards; general use prepaid cards that are both marketed and labeled as a gift card or gift certificate; loyalty, award or promotional gift cards; payroll cards to disburse incentive-based payments; and health savings accounts, flexible spending accounts, medical savings accounts and health reimbursement arrangements.

Registration. The CFPB found during its rulemaking that registration of a prepaid account is generally required by the issuer before a customer can add additional funds to the prepaid account due to the FinCEN Prepaid Access Rule and payment card network rules. The CFPB also noted that issuers have an incentive to register prepaid accounts to increase both the functionality and the customer's use of the prepaid account, and has requested comment on whether it should include a time limit on the registration process.

In order to register a prepaid account, the consumer provides identification information to the issuer or its service provider (*i.e.*, full name, domestic residential address, date of birth and a Social Security Number or Taxpayer Identification Number), most often by telephone or online, and the issuer verifies the information. Under the Proposed Rule, the registration of a prepaid account provides consumers with error resolution and unauthorized transfer rights (described below) and the CFPB has included a required disclosure to consumers noting the importance of registration on the short-form disclosure. The registration of a prepaid account is also relevant to the new Regulation Z requirements, because credit features cannot be offered to a consumer in connection with a prepaid account until 30 days following registration, as discussed below.

Summary of Regulation E Requirements

Card issuers will be required to comply with Regulation E requirements as modified for prepaid card programs.

- An issuer must provide short- and long-form disclosures of the terms of the cards before the consumer agrees to a prepaid card program. The disclosures are subject to specific form and format requirements. Foreign language requirements apply if a foreign language is used on prepaid account packaging material, in person, on the website or the like.
- Where a prepaid account access device is provided, the name of the financial institution and a website or telephone number the consumer can use to contact the institution about the account must be disclosed on the access device. If no physical access device is provided, these disclosures can be provided on the website or other entry point where the consumer accesses the prepaid account electronically.
- An issuer must provide transaction information either (1) on a periodic statement or (2) by making the following information available to the consumer: (a) the account balance, by telephone; (b) a minimum of 18 months of account transactions, electronically; and (c) a minimum of 18 months of account transactions, in writing upon request.
- When providing the transaction information referenced above, the issuer must include a monthly and annual total of all fees imposed and all deposits to and debits from the account.
- Error resolution and unauthorized transfer requirements and limits apply to registered accounts with modifications to the consumer's timing for reporting unauthorized transactions and errors. These requirements do not apply to unregistered accounts if the disclosure of the risks of not registering a prepaid account has been provided to the consumer.
- An issuer must post its prepaid card agreements on its website and provide the agreements to the CFPB.

Card Programs Subject to Regulation Z Requirements

Covered Accounts. Under the Proposed Rule, a prepaid account is defined under Regulation Z as a "credit card" if it has each of the following characteristics:

- Includes an overdraft service or other credit feature; and
- Charges a finance charge or a fee for the credit feature or is payable by written agreement in more than four installments.

Credit. A prepaid account includes a "credit" feature if either (1) a transaction is authorized that exceeds the account balance, or (2) the prepaid account balance is sufficient at the time the transaction is authorized but the transaction exceeds the account balance at the time it is paid.

Fees. Fees for a credit feature include interest, transaction fees, annual fees or other participation fees.

Finance Charge. The Proposed Rule contains changes to the definition of a “finance charge” under Regulation Z for prepaid accounts with a credit feature. Regulation Z currently excludes from the term finance charge those charges imposed for overdrawing an account (unless the payment of the item and the imposition of the charge were previously agreed in writing) and fees charged for participation in a credit plan, whether assessed on an annual or other periodic basis. These exceptions do not apply to credit accessed with a prepaid card. Most importantly, a transaction charge imposed on the prepaid account for each transaction whether or not credit is accessed is considered a finance charge in the event the transaction does access credit. The term finance charge does not include transaction fees imposed when the consumer only withdraws funds from the prepaid account, fees for opening or holding the prepaid account, cash reload fees and balance inquiry fees not imposed because the transaction is funded in whole or in part by credit, or fees for holding a credit plan or for carrying a credit balance.

A prepaid account that offers a credit feature but does not charge a finance charge or a fee for the service and is not payable by written agreement in more than four installments is exempt from the Regulation Z requirements.

Summary of Regulation Z Requirements

Card issuers will be required to comply with Regulation Z credit card rules for both prepaid card accounts with overdraft services and those with separate lines of credit, as summarized below.

- An issuer must perform an ability-to-repay analysis.
- An issuer must obtain a consumer’s consent to overdraft services and credit features.
- An issuer is prohibited from adding credit features until at least 30 calendar days after the consumer registers the prepaid account.
- An issuer must limit total fees in the first year to no more than 25 percent of the initial credit limit.
- An issuer must provide a periodic statement not more often than once per month.
- The consumer must have at least 21 days to repay the debt incurred.
- An issuer is prohibited from requiring offsets from the prepaid account to repay the debt incurred. However, offsets are permitted no more often than once per month if the consumer has a signed written agreement that permits the issuer to do so.
- The consumer must miss two consecutive payments to permit the issuer to increase interest rates.
- Late fees must be “reasonable and proportional.”
- If a point-of-sale transaction is funded by a credit feature, the Regulation Z liability for unauthorized use and claims and defenses against merchants provisions apply.
- If a point-of-sale transaction is funded by a credit feature, the Regulation Z billing error provisions apply.
- An issuer must provide 45 days’ advance notice of any interest rate increase and allow the consumer to cancel the credit feature.

Any new and existing prepaid accounts that have a credit feature will need to include terms required for other credit card products and the issuer must perform a credit review of the consumer, even where the issuer’s initial direct relationship was with someone other than the consumer (e.g., certain payroll or insurance cards).

Next Steps

We recommend that financial institutions review each of their prepaid card programs to determine whether the prepaid card program includes a “prepaid account” subject to Regulation E. As part of this analysis, the financial institution should note whether it requires registration of the card since the requirements vary depending upon whether accounts are registered or not. The financial institution should also note that government benefit card programs and payroll card programs are “prepaid accounts” subject to the Proposed Rule, and that the existing Regulation E requirements for these card programs have changed.

Financial institutions should also determine whether they offer “credit” as defined under the Proposed Rule as part of any prepaid card program. If so, the financial institution must analyze the new definition of a fee and finance charge assessed for

the credit feature to determine whether the card program fees will be attributed to the credit feature, resulting in the application of the Regulation Z credit card requirements to the program.

Once this analysis is complete, the financial institution can then review the Proposed Rule to determine how it must comply with the applicable Regulation E and Regulation Z requirements for each prepaid card program it offers. Financial institutions should identify each of their third-party vendor agreements related to these services and review them to determine how to modify the terms to ensure compliance with the new requirements under the Proposed Rule. In addition, any agreement with prepaid card program sponsors should be reviewed to determine the allocation of potential losses incurred for compliance with unauthorized transfer requirements and limitations on consumer liability, and consideration should be given as to whether a reserve fund should be established to address these potential losses.

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