

Client update

CFPB Proposes Sweeping New Regulation of the Prepaid Market

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On November 13, 2014, the Consumer Financial Protection Bureau (“CFPB” or “Bureau”) released its long-anticipated Notice of Proposed Rulemaking (“Proposed Rule”) regarding the prepaid financial product market. The Proposed Rule would apply the protections of the Electronic Fund Transfers Act (“EFTA”),¹ and its implementing regulation, Regulation E, to “prepaid accounts,” defined broadly in the rule to include: (a) cards, codes or other devices capable of being loaded with funds (other than certain accounts already regulated by Regulation E and gift cards or certificates), (b) that are redeemable upon presentation at multiple, unaffiliated merchants for goods or services, or usable at either automated teller machines (“ATMs”) or for person-to-person (“P2P”) transfers. In conjunction with the Proposed Rule, the Bureau released a study on prepaid account agreements, which reviews the key provisions and protections currently available to consumers.²

The Proposed Rule covers a broader range of prepaid products than contemplated under the 2012 Advanced Notice of Proposed Rulemaking (“ANPR”), including not only general purpose reloadable prepaid cards (“GPR cards”), but also virtual GPR cards accessible via mobile device, certain virtual or digital wallets, P2P payments, payroll cards, tax refund cards, student financial aid accounts and certain government benefit accounts (such as those used to distribute unemployment insurance, child support and pension payments). The Proposed Rule would require certain “short form” and “long form” disclosures in standardized formats to facilitate consumer shopping. The Proposed Rule also contains significant restrictions on the offering of overdraft or other credit products in connection with a prepaid account, incorporating existing protections under the Truth in Lending Act (“TILA”), its implementing

¹ 15 U.S.C. § 1601 *et seq.*

² CFPB, *Study of Prepaid Account Agreements* (Nov. 2014), available at http://files.consumerfinance.gov/f/201411_cfpb_study-of-prepaid-account-agreements.pdf.

regulation, Regulation Z, as well as the Credit Card Accountability Responsibility and Disclosure Act (the “CARD Act”). As one of the CFPB’s first discretionary rulemakings, the Proposed Rule offers important general insights into the Bureau’s priorities and strategy for consumer protection regulation more broadly.

BACKGROUND

Regulation E, the implementing regulation for the EFTA, generally applies to electronic fund transfers, such as debit cards, ATMs, point-of-sale terminals, remote banking services and automated clearinghouses. Over the years, Regulation E has been expanded to include other services, such as electronic benefit transfer cards, gift cards and payroll cards. Regulation E requires issuers, among other things, to disclose fees and other information, assume liability for certain third-party fraudulent activities, written notice of changes in terms and periodic account statements.³

In the CFPB’s May 24, 2012 ANPR, which received over 220 comments, the Bureau sought information about a specific type of prepaid product, the GPR card, including other mechanisms that access a financial account, such as a key fob or cell phone application. The ANPR, among other things, requested comment on how the Bureau should define GPR cards generally and in the context of the EFTA and Regulation E and whether certain prepaid products should be exempted from Regulation E entirely by excluding them from the definition of a GPR card.

In the ANPR, the CFPB offered three factors leading the agency to propose applying Regulation E to GPR cards. First, the GPR market has grown rapidly in the past decade, more than doubling the number of active GPR card users between 2009 and 2012, from 3.4 to 7.0 million.⁴ Second, consumers are increasingly using prepaid accounts as functional replacements for traditional bank checking and savings accounts. Third, while federal regulations protect users of other types of prepaid products, such as payroll cards and gift cards, prepaid accounts are largely unregulated at the federal level. As a result, the CFPB expressed concern that consumers may erroneously believe that prepaid

³ See 12 C.F.R. pt. 1005.

⁴ See also Fed. Reserve Sys., The 2013 Federal Reserve Payments Study, Recent and Long-Term Payment Trends in the United States: 2003-2012, Detailed Report and Updated Data Release (2014), available at https://www.frb-services.org/files/communications/pdf/general/2013_fed_res_paymt_study_detailed_rpt.pdf (finding that the number of prepaid card payments reached 9.2 billion transactions in 2012 up from 5.9 billion in 2009).

accounts provide them the same protections as payroll and gift cards.

Since publication of the ANPR, the CFPB has engaged in four other actions that appear to have influenced the scope of the Proposed Rule. First, in late 2013, the CFPB began meeting with focus groups to gather information about how consumers shop for prepaid cards and subsequently conducted field testing of various consumer model disclosures.⁵ The content of the tested disclosures suggested that the CFPB largely had determined that certain fees needed to be disclosed prior to a consumer's acquisition of the card.

Second, in June 2014, the CFPB issued a request for information regarding the use of mobile financial products and services ("Mobile RFI"). As part of the Mobile RFI, the Bureau sought to understand how mobile technologies impact economically vulnerable consumers with limited access to traditional banking systems. The Bureau received approximately 48 comments in response to its questions regarding the ways in which mobile technologies could expand access to financial services, the use of mobile technologies for real-time money management, the types of customer service or technical assistance that are available to consumers when they use mobile products and privacy and data security issues.

Third, on July 21, 2014, the CFPB began accepting complaints from consumers regarding GPR cards and other prepaid products,⁶ including complaints regarding: (1) problems managing, opening or closing their account; (2) incorrect or unexpected fees; (3) unauthorized transactions or other transaction issues; (4) problems with advertising, marketing or disclosures; (5) difficulties adding money; (6) problems with overdraft, savings or rewards features; and (7) frauds and scams. These complaint fields suggested that the CFPB found that these particular areas posed heightened risks to consumers, thus indicating that these areas could be the subject of rulemaking or, at minimum, increased scrutiny.

Finally, in order to better understand the features and consumer protections currently provided by prepaid products, the CFPB conducted a study of publicly available account agreements for prepaid products that the Bureau believed

⁵ Eric Goldberg, *Prepaid Cards: Help Design a New Disclosure*, CONSUMERFINANCE.GOV (Mar. 18, 2014), <http://www.consumerfinance.gov/blog/prepaid-cards-help-design-a-new-disclosure/>.

⁶ CFPB, *CFPB Begins Accepting Consumer Complaints on Prepaid Cards and Additional Nonbank Products* (July 21, 2014), available at <http://www.consumerfinance.gov/newsroom/cfpb-begins-accepting-consumer-complaints-on-prepaid-cards-and-additional-nonbank-products/>.

could be subject to its proposed definition of the term “prepaid account.” In the study, published with the release of the Proposed Rule, the Bureau reviewed key provisions regarding error resolution protections (including provisional credit), limited liability protections, access to account information, overdraft and treatment of negative balances and declined transaction fees, FDIC (or NCUSIF) pass-through deposit (or share) insurance and general disclosure of fees.

THE PROPOSED RULE

Scope — Definition of Prepaid Account.

Under the Proposed Rule, the definition of “account” in section 1005.2 would be expanded to include a “prepaid account.” The basic goal of the proposed definition is to capture accounts that function in similar fashion to traditional savings and checking accounts in that they separately hold funds of the consumer which may be used for transactions. In particular, the term “prepaid account” would include not only GPR cards as contemplated under the ANPR, but also cards, codes or other devices: (a) not otherwise an account under section 1005.2(b)(1) of Regulation E or marketed and labeled as a gift card or certificate, (b) capable of being loaded with funds and (c) redeemable upon presentation at multiple, unaffiliated merchants for goods or services, or usable at ATMs or for P2P transfers. Thus, the new rule would cover two accounts already subject to Regulation E: payroll cards and government benefit accounts.

The Proposed Rule would exclude from the definition of a prepaid account, cards used for narrower purposes, such as health care and employee benefit related prepaid products as well as those virtual or mobile accounts which do not separately hold funds, but rather merely store payment credentials and thereby provide an alternative device for accessing existing credit card or debit card accounts.

Because of the breadth of the proposed definition, the CFPB acknowledges that its proposal may apply to virtual currency and related products and services. The Bureau observes, however, that its analysis of virtual currency products and services as well as mobile financial products and services (including the applicability of existing regulations and this proposed regulation) is ongoing and not complete. The Proposed Rule seeks comment on whether the Bureau has appropriately defined the scope of the products covered by the proposal and whether there are products it excludes that should be included or vice versa.

The Proposed Rule would amend section 1005.18, the current section of Regulation E imposing specific requirements on payroll cards to adopt specific requirements on prepaid accounts. This section would provide that financial

institutions offering prepaid accounts must comply with the requirements of Regulation E with certain modifications discussed below.

Pre-Acquisition Disclosures.

The Proposed Rule would require new disclosures to be provided by a financial institution before a consumer acquires a prepaid account. In the preamble, the Bureau expresses concern that the lack of standardized disclosures may lead to consumers being unable to effectively evaluate the relative merits of competing prepaid cards, thereby leading to market inefficiencies and higher costs for consumers. By standardizing this information across product lines, it appears the Bureau hopes to facilitate comparison shopping. These proposed disclosures, which were developed through consumer testing and outreach, would include a “short form” and a “long form” disclosure.

Short Form Disclosure. In the “short form,” the issuer would, among other things, provide the prepaid account’s most important fees to facilitate the consumer’s basic understanding of the account’s key terms. These fees would include any periodic fees charged for holding a prepaid account (including variations for those prepaid products offering multiple service plans), per-purchase fees and fees imposed for: domestic ATM withdrawals, cash reloads, domestic ATM balance inquiries, customer service and inactivity. Additionally, issuers would be required to disclose up to three fees not otherwise disclosed that were incurred most frequently in the prior 12-month period by consumers of that particular prepaid account or, for new prepaid account products, up to three fees that they reasonably anticipate will be most incurred by consumers.

In the event the fee amount could vary, the Proposed Rule would require the institution to disclose the highest fee that could be imposed, along with a symbol, such as an asterisk, and accompanying text explaining that the fee could be lower. In addition, the short form would require issuers to include a statement indicating the number of other fees that could be imposed, a statement about any overdraft or credit features available on the card and a statement indicating whether the card provides FDIC or NCUSIF insurance.

Long Form Disclosure. In the “long form,” the issuer would list, in addition to the information required on the short form, all of the fees associated with the prepaid account (including any foreign ATM withdrawal or balance inquiry fees and any fees assessed by third parties) and would include more detailed information on how those fees are assessed. Although issuers generally would be required to provide both the short and long forms pre-acquisition, the Proposed Rule would make certain exceptions for those accounts acquired in

retail stores or orally by telephone, as explained below.

Retail Exception. For prepaid accounts acquired in retail stores, issuers could disclose a URL and telephone number on the short form that a consumer could use to access the content of the long form disclosure prior to purchase. Issuers would not have to provide a stand-alone long form disclosure prior to the consumer's purchase of the prepaid account (although they would have to provide a version of the long form in the terms and conditions included inside the retail packaging or through another method such as in the mail after purchase).

Telephone Exception. For prepaid accounts acquired by telephone, issuers would be required to orally provide the information in the short form disclosure prior to acquisition, but would have the option of informing consumers that they can access the long form by telephone or online. Issuers would not be required to provide the long form disclosure prior to acquisition unless requested.

Special Disclosure Rules for Government Benefit and Payroll Card Accounts. In addition, the Proposed Rule would require government agencies and employers to provide in their pre-acquisition disclosure a statement that the consumer does not have to accept the government benefit or payroll card account and that the consumer can ask about other ways to get their benefit payments or wages instead of receiving them through the account.

E-Sign Consent. The Proposed Rule would not require financial institutions to follow the specific provisions of the E-Sign Act, regarding notice and consent, but would instead give financial institutions flexibility in providing disclosures electronically as long as such disclosures are provided in a manner which is reasonably expected to be accessible in light of how consumers acquire the particular prepaid account.

Overdraft Services and Credit Features.

Although the Bureau acknowledges that the vast majority of prepaid accounts in the market currently do not offer overdraft features, the Proposed Rule devotes significant attention to overdraft and credit features. A number of consumer advocate commenters on the ANPR urged the CFPB to ban such features on prepaid products. Instead, the CFPB took a different approach in the Proposed Rule, generally incorporating certain existing restrictions on credit and other new limits that appear intended to ensure transparency and a degree of separation between prepaid accounts and credit products.

The Proposed Rule acknowledges that overdraft services may provide some

benefit to consumers, and therefore, the Proposed Rule would not prohibit overdraft services or other credit features, but rather would place restrictions when such features are linked to prepaid accounts.

The Proposed Rule also incorporates the CARD Act requirements to credit extensions linked to prepaid accounts. Issuers would be required to determine a consumer's ability to pay prior to providing a credit extension linked to the prepaid account. Further, the Proposed Rule would require issuers to provide consumers 21 days to pay before imposing a late fee, and any late fee must be "reasonable and proportional." In addition, total fees related to the prepaid account must not exceed 25-percent of the credit limit during the first year the consumer opens the account.

The Proposed Rule would define overdraft services as "a line of credit or credit plan subject to Regulation Z, including transfers from a credit card account, home equity line of credit, overdraft line of credit or a credit plan that is accessed by an access device for a prepaid account where the access device is a credit card under Regulation Z." The Bureau states that such credit extensions, including open-end credit plans and credit cards satisfy the definition of "credit" under Regulation Z.

Amendments to Regulation E. The Bureau's stated purpose in amending Regulation E is to provide consumers with greater control over how they enroll in a credit feature or pay prepaid card account balances using an existing credit extension. Under the Proposed Rule, the definition of credit plan would be amended to include a credit card that has access to a prepaid account or a credit card, with an account number, permitting extensions of credit to be deposited into particular prepaid accounts specified by the creditor.

Based on this definition, the Proposed Rule would require issuers to provide a disclosure stating that credit-related fees may apply if a credit plan may be offered in connection with the prepaid account. In cases where no such credit plan is offered, the issuer would be required to provide a statement that no credit-related fee will apply. Issuers would be restricted from applying different terms and conditions on prepaid accounts based on whether the consumer links the account to an overdraft service.

Amendments to Regulation Z. The Proposed Rule would also amend Regulation Z for overdraft services that draw funds from a linked line of credit or forward credit to a prepaid account to cover insufficient funds. Specifically, Regulation Z would apply to those prepaid accounts linked to accounts, such as credit cards or other open-end credit, that charge a fee for the overdraft service, such as interest,

transaction fees or annual fees.

Under the Proposed Rule, issuers would be required to obtain affirmative consumer consent prior to providing overdraft services or other credit features in connection with a prepaid account. In addition, issuers would not be permitted to allow a consumer's prepaid account to be linked with any overdraft services or other credit features until 30 calendar days after the prepaid account is registered with the issuer. The Bureau's stated purpose for applying these restrictions to prepaid accounts is to prevent the risk that consumers will receive such credit services without having significant time to understand their features, and to ensure that consumers will be able to repay any credit received in conjunction with a prepaid account.

Compulsory Use and Offset.

The Proposed Rule would also apply the EFTA and Regulation E's "compulsory use" requirements to prepaid accounts, whereby card issuers would be prohibited from requiring preauthorized transfers to repay credit extended through an overdraft service tied to a prepaid account. The EFTA and Regulation E prohibit any person from requiring consumers to repay credit by a preauthorized electronic fund transfers as a condition of the extension of credit. Because overdraft credit plans linked to prepaid accounts would be subject to Regulation E's compulsory use requirements, creditors would be required to offer an alternative means of repayment, rather than solely through an automatic transfer from a deposit account, for example, to the prepaid account.

In extending the offset provisions in Regulation Z to overdraft plans tied to prepaid accounts, the Proposed Rule would also limit card issuers' ability to transfer funds from a deposit or prepaid account, for example, to pay off any credit card debt at most once per month, and only with written authorization from the cardholder. Taken together, these provisions would place a number of limits on the ability of a card issuer to link the prepaid account funds to associated credit features.

Government Benefit and Payroll Accounts. Under Regulation E, no financial institution or other person can require that a consumer receive an electronic fund transfer into an account at a particular institution as a condition of employment or receipt of a government benefit.⁷ In the Bureau's 2013 Payroll Card Bulletin, the Bureau emphasized that under EFTA and Regulation E an employer may not require that its employees receive their wages by electronic

⁷ 12 C.F.R. 1005.10(e)(2).

transfer to a payroll card account of the employer's choosing.⁸ The Proposed Rule would add a comment on government benefits essentially to mirror the existing commentary on payroll direct deposit to require that a government agency give recipients a choice of having their benefits deposited at a particular institution designated by the government agency or receiving their benefits by another means. The Proposed Rule also includes certain model forms for short form disclosures for government benefit and payroll accounts to clarify that benefit recipients and employees have a choice regarding how to receive their benefits or wages.

Periodic Statements.

Under the EFTA, financial institutions are generally required to provide consumers with a periodic statement either monthly or quarterly depending on the timing of the electronic fund transfer, although Regulation E provides an alternative to such periodic statements for payroll cards. The Proposed Rule would apply the periodic statement provisions in Regulation E and Regulation Z to prepaid card accounts in the following manner.

Amendments to Regulation E. The Proposed Rule would permit an alternative to the periodic statement requirement for prepaid accounts, similar to that for payroll cards under Regulation E. Specifically, a financial institution would not need to furnish periodic statements so long as it provides: (i) the consumer's account balance, through a readily available telephone line; (ii) the consumer's account transaction history, for at least the prior 18 months, electronically or on a website; and (iii) upon the consumer's request, a written copy of the consumer's account transaction history for at least the prior 18 months. The 18-month requirement would be longer than the current 60-day requirement for payroll cards. A similar requirement would apply for benefits provided by government agencies.

Under the Proposed Rule, the electronic and written consumer account transaction histories would have to contain the same information currently required for periodic statements and would include all fees charged on the account for that 18-month period. In addition, the Proposed Rule would require the periodic statements, as well as the electronic or written consumer account transaction histories to include: (i) a summary total of the amount of all fees on the consumer's prepaid account; (ii) the total amount of deposits on the account; and (iii) a total of all the debits from the account for the previous month and for

⁸ See CFPB, Bulletin 2013-10, Payroll Card Accounts (Regulation E) (Sept. 12, 2013), available at http://www.consumerfinance.gov/f/201309_cfpb_payroll-card-bulletin.pdf.

the year to date.

The Proposed Rule states that the Bureau is imposing the disclosure requirements under its authority in the Dodd-Frank Act section 1032(a) to require information (here, all fees and account activity summaries) that will permit consumers to understand the costs, benefits, and risks associated with prepaid accounts. The required disclosures also appear to be based on the Bureau's authority pursuant to section 1033 to require institutions to make available to consumers, upon request, information relating to their use of prepaid accounts, including information relating to any transaction, series of transactions, or the account including costs, charges and usage data. Given the many fee structures found in the market and the variety of consumer usage patterns, it appears the Bureau believes this may be a fruitful area for giving consumers electronic access to transaction histories to enable them to find the most cost-effective product.

Amendments to Regulation Z. Under the Proposed Rule, the periodic statement requirements in Regulation Z would apply to open-end credit plans, credit card accounts or account numbers linked with a prepaid account. Financial institutions would be required to provide a due date disclosure for charge card accounts accessed by a prepaid card and for charge card accounts that allow funds to be deposited into a prepaid account. Further, the issuer would be required to adopt reasonable procedures to ensure that periodic statements are mailed or delivered at least 21 days prior to the disclosed due date. The periodic statement requirement would be separate from the requirement under Regulation E, but financial institutions would be permitted to provide a combined periodic statement with all the necessary disclosures.

Liability and Error Resolution.

The Proposed Rule would generally extend a version of the existing Regulation E and Regulation Z liability and error resolution procedures to prepaid accounts.

Amendments to Regulation E. Regulation E provides for certain liability and notice requirements for unauthorized electronic fund transfers involving a consumer's account. The Proposed Rule would modify the timing of notification for purposes of prepaid accounts by requiring that the 60-day period for reporting any unauthorized transfer begins on the earlier of the date: (i) the consumer accesses their electronic account transaction history; or (ii) the date the financial institution sends a written account transaction history to the consumer. In both cases, the account transaction history would have to include the applicable unauthorized transfer. A financial institution may also comply by

limiting the consumer's liability for unauthorized transfers, as provided under the reporting requirements for unauthorized transfers appearing on a periodic statement, to within 120 days after the transfer was credited or debited to the consumer's account.

The Proposed Rule would also require a financial institution to comply with Regulation E's procedures for resolving errors, including requirements related to provisional credit, with respect to a prepaid account in response to an oral or written notice by a consumer that is received by the earlier of: (i) 60 days after the consumer accesses their electronic account transaction history that reflects the error or (ii) 60 days after the financial institution sends a written account transaction history to the consumer that reflects the error. Alternatively, a financial institution would be deemed to comply with the error resolution procedures if it investigates a consumer's notice of an error within 120 days after the improper transfer was credited or debited to the account. The Proposed Rule would also extend these requirements to government benefit accounts, but would not require these procedures for unregistered prepaid accounts.

Amendments to Regulation Z. The Proposed Rule would also provide that corresponding Regulation Z liability and error resolution procedures would apply to prepaid accounts in cases where credit is extended under a credit plan subject to Regulation Z. Under the Proposed Rule's amendments to Regulation Z, a creditor must comply with the error resolution procedures of Regulation E, if the transaction is partially funded by a transfer from a prepaid account and from credit.

Model Disclosure Clauses and Forms.

The Proposed Rule includes model disclosure forms and clauses for account opening disclosures and error resolution notices, including those used by government agencies and employers. Financial institutions would be provided with a safe-harbor if they use the model clauses and forms.

Implementation Period.

The CFPB is proposing in general, an effective date that would be nine months after the final rule is published in the Federal Register. The Proposed Rule, however, would allow financial institutions to continue selling prepaid account products that do not comply with the final rule's pre-acquisition disclosure requirements for a period of 12 months after the final rule is published if the product and its packaging material were printed prior to the proposed effective date. This proposal follows the ANPR's solicitation of comments regarding how long it generally takes issuers to work through a standing supply of GPR cards

and whether they engage in periodic system maintenance that would allow for updating compliance systems.

Internet Posting of Agreements.

The Proposed Rule would also require issuers to post online on a quarterly basis their agreements as well as any amendments to their prepaid account agreements and associated fee information. The Proposed Rule would exempt issuers with fewer than 3,000 open prepaid accounts as of the last business day of the calendar quarter, and provide a product testing exception if the prepaid product is offered as part of a product test offered to a limited group of consumers for a limited period of time.

CONCLUSION

The broad scope of the Proposed Rule suggests that the CFPB is actively monitoring the prepaid financial product space for emerging product development and changes in consumer behavior. The Proposed Rule signals the CFPB's commitment to increasing transparency for consumers through the use of disclosures that may enable consumers to comparison shop, by highlighting certain pieces of information identified by the Bureau and requiring they be presented in a standardized, easy to compare, format. In addition, the CFPB's focus on overdraft and credit features in the prepaid space may signal its approach to overdraft and other deposit advance products more generally.

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Please do not hesitate to contact us with any questions.