Under the Hood: Prepaid Pistons and Spark Plugs

Presented by:
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Retail Payments Risk Forum
Federal Reserve Bank of Atlanta

Agenda

• Getting to know the ecosystem
• Current program managers and issuers compliance issues
• Oversight overview
• Scope of CFPB’s rule on prepaid accounts
• Trends & Fraud
Noncash Payment Growth Continued

<table>
<thead>
<tr>
<th>Total noncash payments</th>
<th>2012</th>
<th>2015</th>
<th>Change</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number (bil.)</td>
<td>123.5</td>
<td>144.1</td>
<td>20.6</td>
<td>5.3</td>
</tr>
<tr>
<td>Value ($ tril.)</td>
<td>160.88</td>
<td>177.85</td>
<td>16.98</td>
<td>3.4</td>
</tr>
<tr>
<td>Average ($)</td>
<td>1,302</td>
<td>1,234</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Various factors contributed
  - Changes in wealth & income, shopping behavior, replacement of cash payments
- Average value declining
  - Most growth is in smaller-value payments
Debit Card Payments

- Included both non-prepaid and prepaid types
- Non-prepaid debit is the champion by number
  - Reached nearly sixty percent of 2015 card payments
  - Reached nearly forty percent of total noncash payments
- Prepaid debit growth was relatively slow by comparison

### Debit cards

<table>
<thead>
<tr>
<th>Year</th>
<th>Number (bil.)</th>
<th>Value ($ tril.)</th>
<th>Average ($)</th>
<th>Change</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>56.5</td>
<td>2.10</td>
<td>37</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>69.5</td>
<td>2.56</td>
<td>37</td>
<td>13.0</td>
<td>7.1</td>
</tr>
</tbody>
</table>

### Non-prepaid debit cards

<table>
<thead>
<tr>
<th>Year</th>
<th>Number (bil.)</th>
<th>Value ($ tril.)</th>
<th>Average ($)</th>
<th>Change</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>47.3</td>
<td>1.87</td>
<td>40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>59.6</td>
<td>2.29</td>
<td>38</td>
<td>12.4</td>
<td>8.0</td>
</tr>
</tbody>
</table>

### Prepaid debit cards - Sum of GP, PL, and EBT

<table>
<thead>
<tr>
<th>Year</th>
<th>Number (bil.)</th>
<th>Value ($ tril.)</th>
<th>Average ($)</th>
<th>Change</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>9.3</td>
<td>0.23</td>
<td>25</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>9.9</td>
<td>0.27</td>
<td>27</td>
<td>0.6</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Components of Prepaid Debit Card Payments

- Most of the growth in prepaid debit card payments comes from GP prepaid
- GP prepaid growth tapered off considerably since 2009-12
- PL prepaid declined by number but rose by value
  - Not including prepaid transportation card payments
- EBT grew only slightly

### Prepaid debit cards - General purpose

<table>
<thead>
<tr>
<th>Year</th>
<th>Number (bil.)</th>
<th>Value ($ tril.)</th>
<th>Average ($)</th>
<th>Change</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>3.1</td>
<td>0.11</td>
<td>35</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>3.7</td>
<td>0.12</td>
<td>34</td>
<td>0.6</td>
<td>5.6</td>
</tr>
</tbody>
</table>

### Prepaid debit cards - Private label

<table>
<thead>
<tr>
<th>Year</th>
<th>Number (bil.)</th>
<th>Value ($ tril.)</th>
<th>Average ($)</th>
<th>Change</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>3.7</td>
<td>0.05</td>
<td>13</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>3.6</td>
<td>0.07</td>
<td>20</td>
<td>0.0</td>
<td>-0.3</td>
</tr>
</tbody>
</table>

### Prepaid debit - EBT

<table>
<thead>
<tr>
<th>Year</th>
<th>Number (bil.)</th>
<th>Value ($ tril.)</th>
<th>Average ($)</th>
<th>Change</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>2.5</td>
<td>0.07</td>
<td>30</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>2.6</td>
<td>0.08</td>
<td>29</td>
<td>0.1</td>
<td>1.7</td>
</tr>
</tbody>
</table>
Players

Issuer (Bank)  Program Sponsor  Program Manager  Processor

Cardholder  Payment Network Brand

FRB Philadelphia: Insolvency Risk in the Network-Branded Prepaid-Card Value Chain
The basic function

Acquire card/Account opening

Load $$ (who?)

Stored value in account $$

Move $$ or spend

Prepaid or Store-Valued Instrument

Open Loop
- Payroll
- Gift
  - General Purpose Reloadable

Closed Loop
- Gift
  - Transit
  - Phone
  - Reloadable
  - Non-reloadable

Reloadable

Non-reloadable
### Types of Open Loop

<table>
<thead>
<tr>
<th>Consumers</th>
<th>Corporate</th>
<th>Public Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>General purpose reloadable</td>
<td>Payroll</td>
<td>Public benefit &amp; welfare</td>
</tr>
<tr>
<td>Travel</td>
<td>Incentives &amp; rebates</td>
<td>Emergency &amp; disaster recovery</td>
</tr>
<tr>
<td>Online</td>
<td>Healthcare savings</td>
<td>Pension &amp; Social Security</td>
</tr>
<tr>
<td>Campus</td>
<td>Meal vouchers</td>
<td>Travel</td>
</tr>
<tr>
<td>Remittances</td>
<td>Travel</td>
<td>Payroll</td>
</tr>
<tr>
<td>Open loop gift card</td>
<td>Purchasing</td>
<td></td>
</tr>
</tbody>
</table>

### Other Features

- Card Network (Sig & PIN)
- ACH Network (Direct Deposit)
- ACH Network (Account Debit)
- ATM Network
- Surcharge Free ATM Network
- Mobile Alerts / Mobile Inquiries
- Reload Network(s)
- Saving Account
- Bill Pay
- Remittance Partners
- Convenience Checks
- Cash Advance
- Statements

- Paystubs / W-2
- Credit Reporting / Credit Lines
- Merchant Discount Offers
- Reward Programs
- Multi-Card / Multi-Purse
- Sweepstakes Execution
- Contactless / EMV
- Incentive Distribution
- Remote Check Deposit
- P2P / C2C Funds Transfer
- Loyalty Rewards
- ATM Deposits
- Mobile Payments

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Government usage

• EBT Cards
• Mandate for all electronic benefits
• Direct Express Card or other
• IRS- Tax Refunds
• Payroll

Program Manager Responsibilities

✓ Contract with Sponsoring FI
✓ Develop program policies; seeks approvals from FI and desired card brand
✓ Manages program launch
✓ Coordinates all 3rd parties required to deliver services
✓ Card distribution and fulfillment
✓ Provides and reports to FI on cardholder support:
  ✓ Website /IVR
  ✓ Live agent
  ✓ Fulfill Replacement cards
  ✓ Dispute processing
✓ Establishes cardholder agreement’s Terms & Conditions
✓ Develops program for card marketing
✓ Manages funding and settlement accounts
✓ Sets cardholder fee schedule (w/FI)
✓ Ensures compliance with KYC rules
  ✓ OFAC
  ✓ Background checks
Processor Functions: core to add-ons

REGULATIONS

- EFTA Treasury Rule (Government Payments Rule)
- FRB Regulation II – debit interchange
- FinCen (Prepaid Access Rule)
- Dept. Education – Student aid
- CFPB Proposed Rule on Prepaid Accounts
GUIDANCE ENFORCEMENT

• OCC - guidance on managing risk
• FTC (UDAAP)
• FFIEC - CIP
• OFAC
• IRS (health care payments product)
• FFIEC (Information Systems, BSA/AML)
• CARD Act

CFPB RULE

• Scope or Definition of “Prepaid Account”-
  – Payroll
  – Government benefits
  – Marketed as prepaid and for unaffiliated merchants
  – Can be used at ATMs
  – accounts capable of being loaded with funds and can make transactions with unaffiliated merchants or at ATMs,
  – Accounts to conduct person-to- person (P2P) transfers, and that are not checking accounts, share draft accounts, or negotiable order of withdrawal (NOW) accounts
  – EXCLUDES gift, transit, health care, military
Disclosures with specific formatting

- Pre-acquisition
  - Long
    - Comprehensive list of fees
    - How assessed
    - Other program information
  - Short
    - Most important fees
    - Key terms
    - FDIC or NCUA insurance
    - Overdraft?
    - Payroll or government benefit – alternative statement

- Access to account information
- Limited liability and error resolution, including provisional credit
- Submission and posting of prepaid account agreements
- Remittance transfers
- Overdraft credit features
• Definition of “Prepaid Account”
• Pre-Acquisition Disclosures
• Regulation Z on overdraft products
• Implementation timeframes

FDIC NCUA Pass-through Insurance
FinCEN & Money Laundering

- Illegally-gained proceeds appear legal
  - Placement
  - Layering
  - Integration

- BSA Compliance for
  - Financial Institutions and
  - Money Service Business (MSB)
  - Certain Sellers

FinCen Prepaid Access Rule

- Procedures to collect, verify, and retain customer information including name, address, date of birth and identification number
- Submission of SARs for suspicious transactions of $2,000 or more
- Maintaining transactional information for a period of five years
- Know your customer
Dept. of Education Rule

- Cash Management Regulation-
  - October 2015
  - Applies to colleges cash management
  - Prohibits federal financial aid from being disbursed to accounts chosen by college
  - Provide list of options
  - Accounts must be ATM fee-free and have deposit insurance

GIFT CARD RESOURCES

- National Conference of State Legislatures
- CARD Act 2009
- OCC Bulletin No. 96-28, 9, 98-31, 2006-34
STATE LAWS

- Money Transmitter
  - [http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewprepaidmoneytransmitterpdf.pdf](http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewprepaidmoneytransmitterpdf.pdf)
- State Banking Authorities
  - State chartered banks
  - State licensed money transmitters
- State Attorney Generals
  - Unfair/deceptive trade practice laws
  - Unclaimed property laws
  - Wage payment/payroll card laws

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- clarifies that a bank’s CIP should apply to the holders of certain prepaid cards issued by a bank.
- provides an overview of the CIP rule requirements in 31 CFR 1020.220 with regard to the establishment of an account, identification of the customer, and verification of the customer’s identity.
- states that a general purpose prepaid card that can be reloaded by the cardholder or by another party on behalf of a cardholder, or that permits access to credit or overdraft features, creates an account for purposes of the CIP rule.
- clarifies that when an account is created, a customer relationship is established between the issuing bank and the cardholder.
- discusses the application of these principles to other types of prepaid cards, such as payroll and government benefit cards.
- discusses minimum contractual requirements for business relationships between issuing banks and third-party program managers.
Risks

• The Bureau has handled approximately 5,600 prepaid card complaints as of August
  – Concerns have included issues related to
    • accessing funds loaded on the prepaid cards
    • unauthorized transactions,
    • fees,
    • and error resolution
• Identity theft

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