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## Stored Value Cards: Should We Know the Holder?

### I. INTRODUCTION

In the months leading up to September 11, 2001, Mohammed Atta and his 18 fellow hijackers lived in the United States and prepared for their impending terrorist attacks.<sup>1</sup> Members of the group lived in apartments, rented cars and joined local gyms.<sup>2</sup> They took flight lessons, traveled across the country on multiple airline reconnaissance trips, and stayed at hotels.<sup>3</sup> To pay for their living expenses and preparation, the attackers opened accounts at large U.S. banks and used major debit cards to access these accounts and some accounts overseas.<sup>4</sup> The attackers' U.S. bank accounts were funded in part by wire transfers from banks outside the United States.<sup>5</sup> It is believed that approximately \$300,000 in aggregate moved through the attackers' U.S. bank accounts before September 11.<sup>6</sup>

In the months following September 11, the United States enacted tough, new anti-money laundering laws in order to recognize such abnormal banking activity faster in the future.<sup>7</sup> Still, investigators were able to use the paper trail left behind by the attackers' use of traditional U.S. banking products to quickly identify them and construct a picture of their activities.<sup>8</sup> But what

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1. NAT'L COMM'N ON TERRORIST ATTACKS UPON THE UNITED STATES, U.S. GOV'T, 9-11 COMMISSION REPORT 240 (2004), *available at* [http://www.9-11commission.gov/report/911Report\\_Ch7.pdf](http://www.9-11commission.gov/report/911Report_Ch7.pdf).

2. *Id.* at 241.

3. *Id.* at 248.

4. NAT'L COMM'N ON TERRORIST ATTACKS UPON THE UNITED STATES, U.S. GOV'T, MONOGRAPH ON TERRORIST FINANCING 143 (2004), *available at* [http://www.9-11commission.gov/staff\\_statements/911\\_TerrFin\\_Monograph.pdf](http://www.9-11commission.gov/staff_statements/911_TerrFin_Monograph.pdf) [hereinafter U.S. GOV'T MONOGRAPH ON TERRORIST FINANCING].

5. *Id.* at 3.

6. *Id.* at 6.

7. *See* International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272, 296-342 (codified as amended in scattered sections of 31 U.S.C.A.) (Title III of the USA PATRIOT Act).

8. U.S. GOV'T MONOGRAPH ON TERRORIST FINANCING, *supra* note 4, at 6.

if the attackers, instead of using traditional bank accounts, had used one of the banking industry's fastest-growing new offerings – stored value cards – to hold, move, and access their money? The Treasury Department said that “none of these financial footprints would have been available.”<sup>9</sup>

Stored value cards present both considerable opportunity and significant risk to the U.S. banking industry.<sup>10</sup> The volume of cards and card activity is mushrooming,<sup>11</sup> and the cards' unique concept is proving to be a popular way to serve the growing unbanked and underbanked populations.<sup>12</sup> The stored value market has grown to the point where it has become not only profitable for participating businesses, but has also drawn increased scrutiny from regulators, largely centered around state regulations on fees, disclosure,<sup>13</sup> deposit insurance,<sup>14</sup> and the

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9. Chester Dawson, *Prepaid Cards: Candy for Criminals?*, BUSINESS WEEK, Dec. 12, 2005, at 42.

10. Ethan Zindler, *Prepaid Cards Give Rise to Laundering Concerns*, AM. BANKER (New York), Nov. 7, 2005, at 1.

11. See Judith Rinearson, *Prepaid Cards: Coming of Age*, S&P'S THE REVIEW OF BANKING AND FINANCIAL SERVICES, Apr. 1, 2006, 41, at 41, n.11 (stating that the PELORUS Group projects that the number of prepaid debit cards issued annually will surge from 6.2 million in 2002 to almost 40 million in 2007).

12. MONEY LAUNDERING THREAT ASSESSMENT WORKING GROUP, U.S. GOV'T, U.S. MONEY LAUNDERING THREAT ASSESSMENT 20 (2005), available at [http://www.ustreas.gov/press/releases/reports/js3077\\_01112005\\_MLTA.pdf](http://www.ustreas.gov/press/releases/reports/js3077_01112005_MLTA.pdf) [hereinafter MONEY LAUNDERING THREAT ASSESSMENT]; JULIA S. CHENEY, FED. RESERVE BANK OF PHILADELPHIA PAYMENT CARDS CTR., PAYMENT CARDS AND THE UNBANKED: PROSPECTS AND CHALLENGES 5 (July 14, 2005), available at <http://www.philadelphiafed.org/pcc/PaymentCardsandtheUnbankedSummary.pdf> [hereinafter PAYMENT CARDS AND THE UNBANKED: PROSPECTS AND CHALLENGES]. The term “unbanked” refers to any person without a checking or savings account and the term “underbanked” refers to any person who may have one of these accounts but also “rel[ies] on alternative financial service providers for some of their financial needs.” *Id.* at 5, nn.4-5. One recent government estimate stated that there are 10 million unbanked households in the United States. *Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked*, COMMUNITY DEVELOPMENT INSIGHTS (The Office of the Comptroller of the Currency), June 2005, at 1, available at <http://www.occ.treas.gov/cdd/payrollcards.pdf> [hereinafter *Payroll Cards: An Innovative Product*].

13. See Rinearson, *supra* note 11, at 42-43; MARK FURLETTI, FED. RESERVE BANK OF PHILADELPHIA PAYMENT CARDS CTR., PREPAID CARD MARKETS & REGULATION 14-18 (Feb. 2004), available at [http://www.phil.frb.org/pcc/discussion/feb\\_04\\_prepaid.pdf](http://www.phil.frb.org/pcc/discussion/feb_04_prepaid.pdf).

14. See *infra* notes 182-87 and accompanying text. See generally Steven Ritchie, *Consumer Protection Issues: Will Regulators Burst the Prepaid Bubble?*, 9 N.C. BANKING INST. 201 (2005) (explaining the development of the Federal Deposit

transfer of electronic funds.<sup>15</sup> The continued evolution of stored value cards has also introduced to the marketplace new operational mechanics that highlight vulnerabilities in current federal anti-money laundering regulations.<sup>16</sup> Unlike persons holding traditional bank accounts, those purchasing, reloading, or transferring money using certain types of stored value cards are often not required by federal regulation to provide any identifying information.<sup>17</sup> While many companies offering stored value cards nevertheless now require such information, it is unclear how carefully that information is collected because of the lack of regulation requiring it.<sup>18</sup> Few corroborated stories of major money laundering using stored value cards have been publicized, but suspicion is growing in the law enforcement community that these emerging products are ripe for such activity.<sup>19</sup> The fact remains that these cards can potentially offer an anonymous<sup>20</sup> method of entry into banking and credit card payment networks worldwide, while essentially bypassing many of their anti-money laundering regulations.<sup>21</sup>

This Note argues that the joint regulation implementing the customer identification requirements of section 326 of the USA PATRIOT Act should be amended to include open-loop stored

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Insurance Corporation's (FDIC) recent expansion of regulation covering stored value cards).

15. See *infra* notes 174-81 and accompanying text.

16. See MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 21.

17. *Id.* at 20.

18. See Zindler, *supra* note 10, at 5; MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 22. Cf. Payroll Card Systems, OCC Advisory Letter 2004-6 (May 6, 2004), available at <http://www.occ.gov/ftp/advisory/2004-6.doc> (acknowledging that the joint regulation implementing section 326 of the USA PATRIOT Act does not currently apply to payroll cards and other stored value cards by describing the issue as "unsettled," but encouraging financial institutions to comply with it nonetheless in order to protect against "reputation risk and future compliance risk.").

19. *The Investigative Project on Terrorism (ITP): Testimony before the S. Comm. on Banking, Housing and Urban Affairs*, 109th Cong. 19-20 (2005) (statement of Steven Emerson, Exec. Director, ITP) available at [http://banking.senate.gov/\\_files/emerson.pdf](http://banking.senate.gov/_files/emerson.pdf); MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 21; PAYMENT CARDS AND THE UNBANKED: PROSPECTS AND CHALLENGES, *supra* note 12, at 16.

20. For the purposes of this paper, an "anonymous" transaction is one in which the merchant collects no identifying information about the customer. See MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12.

21. See Emerson, *supra* note 19, at 19.

value cards.<sup>22</sup> Part II of the Note describes stored value cards, their development, and their market.<sup>23</sup> Part III describes the current regulatory landscape for stored value cards.<sup>24</sup> Part IV argues that the joint regulation implementing section 326 of the USA PATRIOT Act should be amended to apply to open-loop stored value cards.<sup>25</sup> Part V summarizes issues to be addressed in applying the joint regulation to open-loop stored value cards.<sup>26</sup>

## II. STORED VALUE CARDS: BACKGROUND

Stored value cards are a relatively new and continually evolving entrant in the banking product marketplace.<sup>27</sup> The number of cards and the variety of functionality they offer continue to multiply and change every day.<sup>28</sup> This inventive background has resulted in essentially two different types of cards today – closed-loop and open-loop.<sup>29</sup>

### A. *Closed-loop Stored Value Cards: Background and Market*

“Closed-loop” stored value cards can be used for purchases only within the payment network of a single or finite group of merchants, such as a retail store, chain of stores, mass transit system, or shopping mall.<sup>30</sup> An example of this type of card is a retail gift card, a loyalty card for sale and use exclusively at

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22. See *infra* notes 27-213 and accompanying text.

23. See *infra* notes 27-97 and accompanying text.

24. See *infra* notes 98-139 and accompanying text.

25. See *infra* notes 140-192 and accompanying text.

26. See *infra* notes 193-213 and accompanying text.

27. See Julia S. Cheney & Sherrie L.W. Rhine, *Prepaid Cards: An Important Innovation in Financial Services*, 52 CONSUMER INT. ANN. 370 (2006), available at [http://www.consumerinterests.org/files/public/Rhine\\_PrepaidCardsAnImportantInnovationinFinancialServices.pdf](http://www.consumerinterests.org/files/public/Rhine_PrepaidCardsAnImportantInnovationinFinancialServices.pdf) [hereinafter *Prepaid Cards: An Important Innovation in Financial Services*].

28. See KATY JACOB, CTR. FOR FIN. SERVICES INNOVATION, RESEARCH SERIES WHITE PAPER NO. 1, STORED VALUE CARDS: A SCAN OF CURRENT TRENDS AND FUTURE OPPORTUNITIES 7 (July 2004), available at [www.cfsinnovation.com/managed\\_documents/storedvaluecard\\_report.pdf](http://www.cfsinnovation.com/managed_documents/storedvaluecard_report.pdf).

29. E.g., *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27.

30. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12.

Starbucks,<sup>31</sup> or a campus identification and spending card such as the University of North Carolina OneCard for students, faculty, and staff.<sup>32</sup> These cards cannot be used to access cash or make transactions using worldwide automated teller machine (ATM), point of sale (POS), or major credit card payment networks.<sup>33</sup> Some card designs utilize a chip embedded in the card,<sup>34</sup> but a magnetic stripe-backed card is now the predominant card format.<sup>35</sup>

The first stored value cards were developed in the 1970s by a vending-machine manufacturing company in Italy in response to a rash of pay phone thefts caused by a shortage of metal coins.<sup>36</sup> These closed-loop prepaid phone cards spread within fifteen years throughout Europe, Japan, and the United States.<sup>37</sup>

In the early 1990s, large, nonbank retailers recognized the value of the cards as in-store gift certificates that would cost less than paper-based certificates and improve tracking of balances and redemption.<sup>38</sup> These retailers turned to data processing companies to create computer systems to handle their gift card transactions.<sup>39</sup> The systems they produced were proprietary to each retailer and required that all transactions remained solely within that retailer's

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31. Starbucks, <http://www.starbucks.com> (click on "Starbucks Card" link at top of page) (last visited Jan. 11, 2007).

32. The University of North Carolina at Chapel Hill OneCard, <http://www.onecard.unc.edu> (last visited Jan. 11, 2007). The standard UNC OneCard acts as a campus identification and on-line accounts card, allowing the holder to purchase a wide variety of goods and services at many campus locations. *Id.* UNC also offers a version of its OneCard combined with a Visa Check Card that is linked to the holder's Wachovia Bank account. *See* The University of North Carolina at Chapel Hill OneCard Plus, <http://www.onecard.unc.edu/onecardplus.html> (last visited Jan. 11, 2007). This access to ATM, POS, and credit card networks worldwide makes this version an open-loop stored value card. *See infra* notes 48-53 and accompanying text.

33. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12.

34. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 20 n.44.

35. *See* JACOB, *supra* note 28, at 3; The International Phone Card - a Brief History, Navigata: A SaskTel Company, <http://www.navigata.ca/en/productservices/prepaid-phone-cards/international-phone-card/> (last visited Jan. 11, 2007).

36. The International Phone Card, *supra* note 35.

37. *Id.*

38. *See* Ritchie, *supra* note 14, at 203 (citing Neiman Marcus as the first major retailer to introduce stored value cards); *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27 (citing Blockbuster Video and Kmart as being among the first major retailers to introduce stored value cards).

39. Tom Locke, *Billions in Gift Cards: First Data Plans to Add Loyalty Features in '05*, DENV. BUS. J., Dec. 10, 2004, at A3, A51.

own system and segregated from the national banking system.<sup>40</sup> Also, most gift cards are purchased anonymously<sup>41</sup> and are rarely redeemable for cash.<sup>42</sup>

Closed-loop cards have become ubiquitous in the marketplace, largely in the form of gift cards appearing for sale in the checkout aisle and Web sites of most retail stores and in any denomination a customer might request.<sup>43</sup> Merchants have embraced gift cards for various reasons, including increased customer loyalty, additional store traffic, and extra sales that result from the tendency of gift card recipients to spend more than the original value of their gift card.<sup>44</sup> Consumers favor gift cards because they are easy to use, they require less thought than finding a specific gift, and they allow recipients to choose a gift they want, including the possibility of waiting for merchant mark-down sales in order to “get more gift.”<sup>45</sup> The holiday season is especially strong for the gift card market: a survey conducted by the National Retailers Foundation in anticipation of the 2006 holiday season found that more than seventy-nine percent of consumers polled said they planned to purchase at least one gift card and that the

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40. *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27.

41. See FURLETTI, *supra* note 13, at 2 (noting that these cards “are not embossed with the cardholder’s name”).

42. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 20, 45.

43. *E.g.*, Starbucks, *supra* note 31; Target, <http://www.target.com> (click on “giftcards” link in the second row of links from the top) (last visited Jan. 11, 2007). Being relatively young and still evolving, the stored value card market is often marked by differing taxonomy. For instance, some types of bank-issued stored value cards that are available for use wherever ATM, debit, and major credit cards are accepted are marketed as “gift cards” and some authors refer to them in this manner. See FURLETTI, *supra* note 13 at 7; Ritchie, *supra* note 14, at 203-04. However, this Note will classify only “closed-loop” stored value cards, or those issued by a merchant and available for use at its locations or a finite set of locations, as gift cards. See *supra* note 30 and accompanying text. This Note will consider stored value cards issued by banks or nonbank card marketing companies and available for use wherever ATM, debit and major credit cards are accepted – even if marketed as gift cards – to be “open-loop” stored value cards, by virtue of their access to global payment systems. See *infra* notes 48-53 and accompanying text.

44. FURLETTI, *supra* note 13, at 7; Press Release, First Data Corp., One Store or Any Store – Consumers Say Yes to Gift Cards (Nov. 28, 2006), available at <http://news.firstdata.com/news/releasedetail.cfm?ReleaseID=219900>.

45. Press Release, First Data Corp., Gift Cards Preferred Over Cash by Gift Givers, <http://news.firstdata.com/media/ReleaseDetail.cfm?ReleaseID=144863> (last visited Feb. 16, 2007).

average consumer will spend \$116.51 on gift cards.<sup>46</sup> The survey also indicated that consumers planned to spend a total of \$24.81 billion on gift cards during the holidays, a thirty-four percent increase over 2005.<sup>47</sup>

### B. *Open-loop Stored Value Cards: Background and Market*

“Open-loop” stored value cards can be used to access cash at ATMs and points of sale worldwide, to make purchases at points of sale,<sup>48</sup> and, depending on the specific card, might be used to make purchases wherever major credit cards are accepted.<sup>49</sup> Examples of open-loop cards include the Visa Reloadable Prepaid Card,<sup>50</sup> AccountNow Vantage Prepaid MasterCard,<sup>51</sup> and the Huntington Bank PowerPay Payroll Card.<sup>52</sup> Their access to one or both global payment networks distinguishes these as “open-loop.”<sup>53</sup>

#### 1. Open-loop: Payroll Cards

Stored value cards continued to evolve in the mid-1990s when long-haul trucking employers began using them as a payroll device for their constantly-moving drivers who did not have a personal bank account and to whom they could not send a check.<sup>54</sup>

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46. Press Release, National Retail Federation, Holiday Gift Card Sales Reach All-Time High, According to NRF (Nov. 17, 2006), <http://www.nrf.com/content/default.asp?folder=press/release2006&file=2006giftcards.htm>.

47. *Id.*

48. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12. Examples of ATM networks include Visa's Plus (ATM) and Interlink (POS) and MasterCard's Cirrus (ATM) and Maestro (POS). *Id.* at 20 n.43.

49. *Id.* Examples of credit card payment networks include Visa, MasterCard, American Express, and Discover. See Rinearson, *supra* note 11, at 42.

50. Visa Reloadable Prepaid Card, [http://www.usa.visa.com/personal/cards/prepaid/reloadable\\_prepaid\\_card.html](http://www.usa.visa.com/personal/cards/prepaid/reloadable_prepaid_card.html) (last visited Jan. 11, 2007).

51. AccountNow Vantage Prepaid MasterCard, <http://www.accountnow.net/default.aspx> (last visited Jan. 11, 2007).

52. Huntington Bank Payroll Card, <https://www.huntington.com/tm/TM77.htm> (last visited Jan. 11, 2007).

53. *E.g.*, MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12.

54. Diane E. Lewis, *It's All in the Card*, BOSTON GLOBE, Feb. 15, 2004, at E5, available at [http://www.boston.com/business/articles/2004/02/15/its\\_all\\_in\\_the\\_card/](http://www.boston.com/business/articles/2004/02/15/its_all_in_the_card/). For a full discussion of stored value payroll cards, see Beth S. DeSimone & Carrie A.



This product requires employers, banks, and perhaps data processing companies (depending on the business arrangement) to utilize a transaction processing system connected to global banking networks that allows employers to deposit payroll money directly into a PIN-protected<sup>55</sup> account held at a bank in the name of the employer.<sup>56</sup> The employee keeps a stored value card in his or her possession and, once the payroll deposit is made, he or she can access the cash through an ATM or POS and make purchases at the POS.<sup>57</sup> In this respect, these cards are functionally equivalent to traditional debit cards tied to bank accounts.<sup>58</sup> Notably, some versions of these cards are not branded by major credit card companies, so they cannot be used in the major credit cards' payment systems.<sup>59</sup> The main benefits of payroll cards are significantly lower payroll transaction costs for employers,<sup>60</sup> added revenue streams for banks and other businesses playing a role in the transaction,<sup>61</sup> and convenience, safety, and lower costs for consumers.<sup>62</sup> This type of stored value payroll card remains popular in the marketplace.<sup>63</sup>

The payroll card market welcomed another evolution of the stored value card in 2001 when Visa and MasterCard began to offer branded payroll cards that also offer access to their own

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O'Brien, *Payroll Cards: Would You Like Your Pay With Those Fries?*, 9 N.C. BANKING INST. 35 (2005).

55. PIN-protected accounts require the entry of a Personal Identification Number (PIN) in order to access the account. Consumers may enter their PIN at ATMs to withdraw cash or at some merchant points of sale to make purchases and receive cash back. Wikipedia, The Free Encyclopedia, Personal identification number, [http://en.wikipedia.org/w/index.php?title=Personal\\_identification\\_number&oldid=92433890](http://en.wikipedia.org/w/index.php?title=Personal_identification_number&oldid=92433890) (last visited Jan. 11, 2007).

56. *Payroll Cards: An Innovative Product*, *supra* note 12, at 5; *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 371-72.

57. *Payroll Cards: An Innovative Product*, *supra* note 12, at 4-5.

58. FEDERAL RESERVE BANK OF NEW YORK, STORED VALUE CARDS: AN ALTERNATIVE FOR THE UNBANKED? (2004), [http://www.ny.frb.org/regional/stored\\_value\\_cards.html](http://www.ny.frb.org/regional/stored_value_cards.html).

59. *See Payroll Cards: An Innovative Product*, *supra* note 12, at 5. Major credit card companies utilize worldwide, signature-based payment networks which are separate from PIN-based ATM and POS networks. *See id.* at 14.

60. *Id.* at 3.

61. *Id.* at 2.

62. *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 371.

63. *See Payroll Cards: An Innovative Product*, *supra* note 12, at 2.

worldwide, signature-based payment systems.<sup>64</sup> These companies recognized the merit and fee potential in a stored value product<sup>65</sup> for the growing population of unbanked and underbanked individuals, who previously conducted most or all of their business in cash or paid hefty fees for check-cashing services and money orders.<sup>66</sup> This type of stored value card allows users not only to access their pay in cash at ATMs and points of sale and make purchases at points of sale, but also to make purchases wherever their credit card brand is accepted.<sup>67</sup> Of paramount importance to credit card companies, however, is the low risk, as these cards bear no credit risk since they are prepaid,<sup>68</sup> and they bear little customer identification risk since the employee's identity is typically already known and confirmed by the employer.<sup>69</sup>

The use of payroll cards increased significantly after the September 11, 2001, terrorist attacks when many deliveries of payroll checks were halted due to the grounding of the nation's air transportation system.<sup>70</sup> The payroll card market gained more momentum from the decision by Visa and MasterCard in 2001 to offer branded cards.<sup>71</sup> According to one research group, there were 2.3 million payroll cards in circulation in 2003, and it estimated that number would rise to 6.8 million in 2006.<sup>72</sup> Another research group estimated that payroll cards "will be worth \$143 billion in transactions in 2007."<sup>73</sup>

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64. PAYMENT CARDS AND THE UNBANKED: PROSPECTS AND CHALLENGES, *supra* note 12, at 10-11.

65. See *Payroll Cards: An Innovative Product*, *supra* note 12, at 2-4.

66. *Id.* at 8.

67. *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 371. These types of cards may also be used to distribute benefits and non-cash incentives to employees. See, e.g., American Express Incentive Services, <http://www.aeis.com/home/index.htm> (last visited Jan. 11, 2007).

68. See *id.* at 2.

69. *Payroll Cards: An Innovative Product*, *supra* note 12, at 7. Banks may also confirm employees' identity using outside means. See *id.*

70. *Payroll Cards: An Innovative Product*, *supra* note 12, at 3.

71. See *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 371-72 (citing examples of companies using payroll cards include Coca-Cola, McDonald's, Denny's, and UPS).

72. Lewis, *supra* note 54 (citing figures from Financial Insights).

73. JACOB, *supra* note 28, at 6 (citing figures from Financial Insights).

## 2. Open-loop: General Spending Reloadable Cards

General spending reloadable cards are similar to the payroll cards that offer universal access to ATMs, points of sale and major credit card payment networks, except that funding for the cards need not originate from an employer's deposit of payroll funds.<sup>74</sup> Rather, consumers can buy these cards directly from financial institutions and nonbank card marketing companies<sup>75</sup> and fund them with cash, paper checks, and transfers of money from other bank accounts and stored value accounts.<sup>76</sup> Some examples of these include WebSecret,<sup>77</sup> RushCard,<sup>78</sup> Citibank Prepaid MasterCard,<sup>79</sup> and Visa Buxx for Teens.<sup>80</sup>

At the moment, many different types of businesses play roles in this growing and often confusing market.<sup>81</sup> In some arrangements, banks or credit card companies issue the cards directly to consumers and manage the funds in bank accounts listed under the consumer's name.<sup>82</sup> Often, when opening these accounts, banks and credit card companies follow the same customer identification regulations applicable to their regular products.<sup>83</sup> However, in other arrangements a nonbank card marketing company sells cards directly to consumers via the

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74. See *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372-73.

75. Some examples of nonbank card marketing companies include: GreenDot Corporation, <http://www.greedotcorp.com> (last visited Jan. 11, 2007); eCount, <http://www.ecount.com> (last visited Jan. 11, 2007); NetSpend, <http://www.netspend.com> (last visited Jan. 11, 2007); and MetaBank, <http://www.metabankonline.com> (last visited Jan. 11, 2007).

76. *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372-73.

77. Websecret, <https://www.websecretcard.com> (last visited Jan. 11, 2007).

78. RushCard, <https://www.rushcard.com> (last visited Jan. 11, 2007).

79. Citibank Prepaid MasterCard, <https://www.greendotonline.com/citi/> (last visited Jan. 11, 2007).

80. Visa Buxx for Teens, [http://www.usa.visa.com/personal/cards/prepaid/visa\\_buxx.html](http://www.usa.visa.com/personal/cards/prepaid/visa_buxx.html) (last visited Jan. 11, 2007).

81. JACOB, *supra* note 28, at 4.

82. *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 373-74 (discussing the functionality of two types of stored value cards issued directly by banks, with the necessary implication that the bank deals directly with the customer).

83. Zindler, *supra* note 10, at 5.

Internet, telephone, or an agent, such as a retail partner.<sup>84</sup> Despite a general lack of regulation requiring many nonbank card marketing companies and their agents to implement customer identification procedures,<sup>85</sup> a growing number now do.<sup>86</sup> It has been reported that Visa and MasterCard now require customer identification – whether collected by them or by a partner nonbank card marketing company – for cards that will use their payment networks.<sup>87</sup> However, at least one card, Websecret (branded by MasterCard), advertises that it may be purchased and used anonymously for certain transactions.<sup>88</sup> Some nonbank card marketing companies allow a second card to be linked to the account for use by friend or spouse or for remittance to or from another country.<sup>89</sup> In order to manage the funds received from each transaction, the nonbank card marketing company typically deposits them with a bank in a “pooled” account or “sub-

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84. *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372. See *supra* note 75 and accompanying text (providing examples of nonbank card marketing companies).

85. These nonbank card marketing companies and their agents may, in some circumstances, be considered money services businesses (MSB), 31 C.F.R. § 103.11(uu) (2006), and be required to implement an anti-money laundering (AML) program that includes a customer identification obligation, 31 C.F.R. § 103.125 (2006), but if they avoid issuing, selling, or redeeming an amount greater than \$1,000 per customer, per day, they are not required to verify customer identification. *Id.*

86. Examples of companies requiring customer identification at the time of purchase include: Visa (Buxx), *supra* note 80; RushCard, *supra* note 78; and Citibank (Prepaid MasterCard), *supra* note 79.

87. See JACOB, *supra* note 28, at 5; see also MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 22. The nonbank card marketing companies that choose to collect customer identification could be acting at the request of credit card companies as part of their required anti-money laundering programs. See *infra* notes 125-27 and accompanying text. They could also be acting at the request of banks whose accounts they use. See OCC Advisory Letter 2004-6, *supra* note 18. Finally, they could perhaps be acting on their own, anticipating future regulatory measures directed toward them. *Id.* With no formal obligation to collect customer identification information, it is unclear how carefully the information is currently being collected. See *id.*

88. Websecret Terms and Conditions, <https://www.websecretcard.com/terms.aspx> (last visited Jan. 11, 2007).

89. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12; *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 373-74. Immigrant populations in the United States consider the ability to remit money to relatives or friends in foreign countries an attractive feature of some stored value cards. See PAYMENT CARDS AND THE UNBANKED: PROSPECTS AND CHALLENGES, *supra* note 12, at 15. Bank of America has said that sixty-five percent of Hispanic immigrants living in the United States send money to family members in their home country. *Id.*

accounts” listed under the nonbank card marketing company’s name.<sup>90</sup> This account is usually located at a bank that is part of a major credit card network in order to ensure that the stored value cards will carry that credit card’s branding and offer access to its global payment network.<sup>91</sup> Transaction processing is provided by the bank holding the account, a third-party data processing company, or perhaps the nonbank card marketing company itself.<sup>92</sup> Each of these various parties may – and often do – charge a fee per transaction or time period (e.g., monthly), or for checking a balance, adding cash, replacing a card, disputing a charge, overdrafting, or even for inactivity.<sup>93</sup>

In summary, most general spending reloadable stored value business arrangements include some combination of three main parties: 1) banks; 2) credit card companies; and 3) nonbank card marketing companies.<sup>94</sup> The result of this complex web of participants and responsibilities is a product that can potentially be purchased anonymously, used to access cash at ATMs, make purchases and/or receive cash back at points of sale, make payments wherever major credit cards are accepted, carry an ongoing balance, and be reloaded indefinitely.<sup>95</sup>

The growth of general spending reloadable cards is also bound to increase significantly in the coming years.<sup>96</sup> A research report issued in 2005 suggests that “the number of U.S.-issued Visa

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90. *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372.

91. *See id.*

92. *Id.* at 8-9.

93. *See* FEDERAL RESERVE BANK OF NEW YORK, *supra* note 58; JACOB, *supra* note 28, at 7-10; FURLETTI, *supra* note 13, at 10. Fees and expiration dates on cards, as well as inappropriate or nonexistent disclosure of such fees and expiration dates, has prompted review by the Federal Trade Commission and many state and local regulatory bodies. Rinearson, *supra* note 11, at 42-43 (citing, in part, Gift Cards 2005: Many Good Retail Cards. Any Good Bank Cards? Montgomery County Division of Consumer Affairs (Dec. 1, 2005) available at [http://www.montgomerycountymd.gov/content/ocp/consumer/gift\\_cards\\_report\\_2005.pdf](http://www.montgomerycountymd.gov/content/ocp/consumer/gift_cards_report_2005.pdf) (last visited Dec. 22), 2005)). At least four states have filed lawsuits against mall operator Simon Malls over the terms and conditions of some of its stored value cards. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 20 n.47.

94. *See Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372-73.

95. *See id.* at 8.

96. *Id.* at 10.

and MasterCard-branded prepaid [general spending] cards is likely to reach over 1 million in 2006 . . . from the 400,000 cards issued in 2005.”<sup>97</sup>

### III. CURRENT REGULATORY LANDSCAPE FOR STORED VALUE CARDS

#### A. *USA PATRIOT Act, Section 326*

Just six weeks after the September 11, 2001, terrorist attacks, President Bush signed into law the USA PATRIOT Act, wide-ranging legislation that strengthens the authority of the U.S. government to fight terrorism at home and around the world.<sup>98</sup> Title III of the Act, captioned “International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001,”<sup>99</sup> expands the provisions of the Bank Secrecy Act (BSA)<sup>100</sup> to impose on financial institutions record-keeping and reporting duties designed to aid in anti-terrorism intelligence operations.<sup>101</sup> Section 326 of the USA PATRIOT Act amends the Bank Secrecy Act to direct the Secretary of the Treasury to prescribe regulations requiring financial institutions to establish procedures for:

verifying the identity of any person seeking to open an account to the extent reasonable and practicable; maintaining records of the information used to verify a person’s identity, including name, address, and other identifying information; and consulting lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency to determine whether a

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97. *Id.* (citing figures from the Aite Group).

98. USA PATRIOT Act, Pub. L. No. 107-56, 115 Stat. 272 (2001) (codified as amended in scattered sections of 18 U.S.C., 28 U.S.C., 31 U.S.C., 47 U.S.C., 50 U.S.C., among others).

99. International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, Pub. L. 107-56, 115 Stat. 272, 296-342 (2001) (codified in scattered sections of 31 U.S.C.A.).

100. Bank Secrecy Act, Pub. L. No. 91-508, 84 Stat. 1114 (codified as amended in scattered parts of 5 U.S.C.A., 7 U.S.C.A., 12 U.S.C.A., 15 U.S.C.A., 49 U.S.C.A.).

101. USA PATRIOT Act § 302, 31 U.S.C.A. § 5311 (2002).

person seeking to open an account appears on any such list.<sup>102</sup>

The Bank Secrecy Act defines a “financial institution” to which Section 326 applies as, among other things:

(A) An insured bank . . . ; (B) a commercial bank or trust company; . . . (K) an issuer, redeemer, or cashier of traveler’s checks, checks, money orders, or similar instruments; (L) an operator of a credit card system; . . . (Y) any business or agency which engages in any activity which the Secretary of the Treasury determines, by regulation, to be an activity which is similar to, related to, or a substitute for any activity in which any business described in this paragraph is authorized to engage; or (Z) any other business designated by the Secretary whose cash transactions have a high degree of usefulness in criminal, tax or regulatory matters.<sup>103</sup>

Although the statute does not expressly mention stored value cards, it is broad enough to be applicable to the businesses participating in most stored value business arrangements.<sup>104</sup> The Treasury Department’s Financial Crimes Enforcement Network (FinCEN) has acknowledged that stored value cards were not contemplated in Section 326 when it was enacted in 2001 because the cards were so new at the time that regulators were uncertain

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102. USA PATRIOT Act § 326, 31 U.S.C.A. § 5318(l) (2002). For the purposes of this Note, this amended statute will be referred to as “Section 326” or “the Section 326 statute.”

103. 31 U.S.C. § 5312(a)(2) (2000).

104. See *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372-73 (explaining that the three main participants in most stored value business arrangements are banks, credit card companies, and nonbank card marketing companies). The BSA expressly applies to banks (provisions (A) and (B) in the BSA definition of financial institution) and credit card companies (provision (L)), and could reasonably apply to nonbank card marketing companies through provision (Y), or perhaps (K) or (Z). See 31 U.S.C. § 5312.

how they would be used and what money-laundering risks would materialize.<sup>105</sup>

### B. *The Joint Regulation Implementing Section 326*

The Secretary of the Treasury, in consultation with various federal agencies,<sup>106</sup> used the Section 326 statutory grant of authority to issue a regulation (joint regulation) requiring banks to employ a specific Customer Identification Program (CIP) that collects, at a minimum, a customer's name, date of birth (for an individual), address, and identification number.<sup>107</sup> Notably, the joint regulation applies only to banks, savings associations, credit unions, and some other similar organizations.<sup>108</sup> The Secretary has issued regulations requiring CIPs for some other types of financial institutions,<sup>109</sup> but not for those typically involved in stored value business arrangements, including nonbank card marketing companies and credit card companies.<sup>110</sup>

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105. David Breitkopf, *Regulators Eye Payroll Cards*, AM. BANKER (New York), May 24, 2004, at 5.

106. The participating agencies were the Federal Deposit Insurance Corporation, Department of the Treasury, Office of Thrift Supervision, National Credit Union Administration, Federal Reserve System Board of Governors, Department of the Treasury Financial Crimes Enforcement Network, and Department of the Treasury Office of the Comptroller of the Currency. Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25,090, 25,090 (proposed May 9, 2003) (codified in scattered parts of 12 C.F.R. and 31 C.F.R.).

107. 31 C.F.R. § 103.121(b)(2)(i)(1-4) (2006). Subject to some exceptions, the identification number for a U.S. individual can be a social security number and for a business can be an employer identification number. § 103.121(a)(6) (citing 26 U.S.C. 6109 and the Internal Revenue Service regulations implementing that section). Non-U.S. persons without a social security number may provide other forms of identification from their home country. § 103.121(b)(2)(i)(4)(ii). Non-U.S. businesses without an identification number must provide alternative government-issued documentation. § 103.121(b)(2)(i)(4)(ii)(NOTE). For a full discussion of foreign individuals' use of a foreign consular card as identification, see Kathryn Lee Holloman, *Anti-Terrorism Banking Issues: The New Identity Crises: USA PATRIOT Act Customer Identification Programs and the Matricula Consular as Primary Identification Verification for Mexican Nationals*, 7 N.C. BANKING INST. 125 (2003).

108. 31 C.F.R. § 103.121.

109. 31 C.F.R. § 103.122 (customer identification for broker-dealers); 31 C.F.R. § 103.123 (for futures commissions merchants and introducing brokers); 31 C.F.R. § 103.131 (for mutual funds).

110. In certain circumstances, nonbank card marketing companies may be considered MSBs and therefore be subject to appropriate regulation. *Supra* note 85 and accompanying text. MSBs and operators of credit card systems are not subject to



The joint regulation describes the required CIP as “risk-based,” which means it gives banks latitude in creating their own CIP procedures so long as they “enable the bank to form a reasonable belief that it knows the true identity of each customer.”<sup>111</sup> The joint regulation states:

[The] procedures must be based on the bank’s assessment of the relevant risks, including those presented by the various types of accounts maintained by the bank, the various methods of opening accounts provided by the bank, the various types of identifying information available, and the bank’s size, location, and customer base.<sup>112</sup>

The joint regulation defines a “customer” whose identity must be verified as “a person that opens a new account”<sup>113</sup> but not “[a] person that has an existing account with the bank, provided that the bank has a reasonable belief that it knows the true identity of the person.”<sup>114</sup>

The joint regulation defines an “account” as “a formal banking relationship established to provide or engage in services, dealings or other financial transactions including a deposit account, a transaction or asset account, a credit account, or other extension of credit.”<sup>115</sup> It states that an account does *not* include “[a] product or service where a formal banking relationship is not established with a person, such as check-cashing, wire transfer, or sale of a check or money order.”<sup>116</sup> The regulation does not

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specific CIP requirements, but both are required to employ broader AML programs. *See infra* notes 125-32 and accompanying text. Nonbank card marketing companies that are not considered MSBs are not expressly subject to any regulation, although they could be interpreted to be subject to the BSA and its AML requirements for all financial institutions. *See supra* note 104 and accompanying text (noting that the BSA’s definition of financial institution could reasonably apply to nonbank card marketing companies through provision (Y), or perhaps (K) or (Z)).

111. *See* 31 C.F.R. § 103.121(b)(2).

112. *Id.*

113. 31 C.F.R. § 103.121(a)(3)(i)(A) (2006). For the purposes of this regulation, “persons” also include corporations, partnerships, and trusts. § 103.121(a)(7).

114. § 103.121(a)(3)(ii)(C).

115. § 103.121(a)(1)(i).

116. § 103.121(a)(1)(ii)(A).

expressly mention stored value accounts or whether they should be considered similar to deposit accounts, payment instruments, or neither.<sup>117</sup>

The Office of the Comptroller of the Currency recently confirmed in an advisory letter the ambiguity of the regulatory landscape related to stored value cards by describing it as “unsettled,” while encouraging banks that offer these products to comply with the regulatory CIP requirements in stored value card transactions anyway “to protect the bank against reputation risk and future compliance risk.”<sup>118</sup>

### C. *Other Relevant Bank Secrecy Act Statutes and Implementing Regulations*

Although the joint regulation implementing Section 326 does not apply to banks outside of their traditional deposit, transaction, and credit account activities,<sup>119</sup> or to nonbank card marketing companies and operators of credit card systems in any of their activities,<sup>120</sup> other statutes and regulations impose broader anti-money laundering (AML) programs and some customer identification requirements on these financial institutions. The BSA, for example, requires all financial institutions to establish an AML program and gives the Secretary of the Treasury the power to establish by regulation their minimum standards.<sup>121</sup>

The Secretary used the BSA, as well as Section 326, as authority to issue a regulation setting minimum requirements for AML programs for all financial institutions regulated by a Federal functional regulator or a self-regulatory organization, a group that may include banks, savings associations, credit unions, and other similar organizations.<sup>122</sup> This regulation does not specifically

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117. See § 103.121(a)(1)(i), (ii).

118. OCC Advisory Letter 2004-6, *supra* note 18. The advisory letter focuses on payroll cards but expressly states that it also “provides useful guidance with respect to other forms of stored value cards.” *Id.* at n.3.

119. *Supra* notes 108, 115-17 and accompanying text.

120. *Supra* note 110 and accompanying text.

121. 31 U.S.C. § 5318(h) (2000).

122. 31 C.F.R. § 103.120 (2006). This regulation also sets minimum standards for AML programs at casinos. *Id.*

impose customer identification regulations or specifically mention stored value cards.<sup>123</sup> However, the Section 326 joint regulation states that, if a bank is required to have an AML program, then the AML program must contain a CIP.<sup>124</sup>

The Secretary also used the BSA and Section 326 as authority to issue a regulation requiring operators of credit card systems to institute a written AML program “reasonably designed to prevent the operator of a credit card system from being used to facilitate money laundering and the financing of terrorist activities.”<sup>125</sup> The program must, among other things, “incorporate policies, procedures, and internal controls” designed to guard against the operator allowing another institution to issue credit cards on its behalf or contract with merchants or others to process transactions on its behalf in a way that facilitates money laundering or the financing of terrorist activities.<sup>126</sup> However, the regulation does not include specific customer identification requirements.<sup>127</sup>

Additionally, the Secretary used the BSA and Section 326 as authority to issue a regulation requiring money services businesses (MSB) – which may include some nonbank card marketing companies<sup>128</sup> – to institute an AML program “reasonably designed to prevent the MSB from being used to facilitate money laundering and the financing of terrorist activities.”<sup>129</sup> MSBs are defined as check cashers, currency dealers, and issuers, sellers, and redeemers of traveler’s checks, money orders, or stored value that transact business in an amount greater than \$1,000 per customer, per day.<sup>130</sup> If the organization transacts this amount or less per customer, per day, it is not subject to this regulation.<sup>131</sup> Among the regulation’s provisions is a specific requirement to verify customer identification, although the

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123. *See id.*; § 103.176; § 103.178.

124. § 103.121(b)(1).

125. § 103.135(b) (2006).

126. § 103.135(c)(1)(i).

127. *See* § 103.135.

128. *Supra* note 85 and accompanying text.

129. § 103.125.

130. § 103.11(uu)(1)-(4).

131. *See* § 103.125 (2006).

regulation provides no detail about how to satisfy the requirement.<sup>132</sup>

In addition to regulations imposing broad AML requirements, other regulations impose identification and/or reporting requirements on certain transactions based upon the values of those transactions. Currency dealers or exchangers that exchange currency of at least \$1,000 in a single transaction must verify the customer's identification.<sup>133</sup> MSBs that engage in transactions they deem suspicious and that involve at least \$2,000 must report them to the government.<sup>134</sup> Banks that engage in transactions they deem suspicious and that involve at least \$5,000 must report them to the government.<sup>135</sup> Financial institutions that issue or sell monetary instruments worth between \$3,000 and \$10,000 to a single customer in a single day must verify the customers' identification.<sup>136</sup> Financial institutions that engage in transactions involving currency of more than \$10,000 must verify the customers' identification<sup>137</sup> and report the transactions to the government.<sup>138</sup> Any person engaged in a trade or business who receives currency in excess of \$10,000 in related transactions must report the transaction to the government.<sup>139</sup>

#### IV. THE SECTION 326 JOINT REGULATION SHOULD BE AMENDED TO APPLY TO OPEN-LOOP STORED VALUE CARDS

##### A. *Which Stored Value Cards Should be Subject to the Regulation?*

Not all stored value cards are alike.<sup>140</sup> Closed-loop stored value cards may only be used for purchases within the payment

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132. See § 103.125(d)(1)(i)(A).

133. § 103.37.

134. § 103.20.

135. § 103.18.

136. § 103.29 (2006).

137. § 103.28.

138. § 103.22.

139. § 103.30.

140. E.g., *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 370-71 (noting the difference between closed-loop and open-loop stored value cards).

network of a single or a finite group of merchants, and they typically may not be used to access cash or receive cash back after a purchase.<sup>141</sup> While some evidence of money laundering using these products has surfaced,<sup>142</sup> closed-loop stored value cards lack the most important functional characteristic for money-laundering risk: access to global ATM, POS, and/or credit card payment networks.<sup>143</sup> Therefore, closed-loop stored value cards should be subject to separate and appropriate regulation tailored to their unique functionality and risks, but need not be subject to the same federal customer identification regulation as open-loop stored value cards.

In contrast, open-loop stored value cards do offer access to global ATM, POS, and/or credit card payment networks.<sup>144</sup> Because of this characteristic and other arguments to follow in this section, the regulation implementing Section 326 should be amended to apply to open-loop stored value cards.<sup>145</sup>

*B. Similar Functionality Produces Similar Money-Laundering Risks*

Open-loop stored value cards offer customers – and criminals – nearly the same functionality as a traditional bank account in managing and moving their money, using only a marginally different business model.<sup>146</sup> Therefore, these products produce the same money laundering risks and should also be subject to the Section 326 customer identification joint regulation.

Open-loop stored value card accounts are, in reality, bank accounts: the funds comprising the value of an open-loop stored

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141. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12.

142. *Id.* at 20-21.

143. *Id.* at 20.

144. *Id.*

145. Some may argue that open-loop payroll cards should not be subject to such regulation because they present less risk than other open-loop stored value cards due to the facts that the flow of money into the account may be limited to only deposits by an employer and customer identification is often already completed by the employer. However, the same arguments also weigh in favor of regulation because they would reduce the costs of compliance.

146. See FEDERAL RESERVE BANK OF NEW YORK, *supra* note 58 (“[A] reloadable multipurpose card may provide a level of functionality equal to or better than a traditional check account . . .”).

value card, regardless of whether they originated from a payroll transfer, card purchase, reload, or transfer of funds, are eventually deposited in a bank account.<sup>147</sup> Therefore, stored value account transactions and traditional bank account transactions ultimately use the same payment networks.<sup>148</sup> This fact alone renders the two business models very similar and results in important functional parallels. Open-loop card users can access cash at ATMs and points of sale across the country and all over the world, just as if they had a personal bank account tied to an ATM and/or debit card.<sup>149</sup> Depending on the type of card, users may also be able to make purchases at points of sale wherever in the world debit and credit cards are accepted.<sup>150</sup> Also, many open-loop stored value cards allow for a second card to be added to the account for use by family members anywhere in the world.<sup>151</sup> Yet another important functional similarity is that many open-loop stored value cards are structured to remain open indefinitely, allowing users to reload their accounts, carry an ongoing balance and thus, maintain a continuing relationship similar to that of a traditional bank account.<sup>152</sup> From the perspective of a consumer – or a criminal – open-loop stored value cards offer equivalent or better functionality to that of traditional bank accounts.<sup>153</sup>

Logistically, the main difference between bank accounts holding stored value funds and those holding traditional deposits is often the name under which the account is listed with the bank.<sup>154</sup>

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147. See MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 22.

148. *Id.* at 21.

149. See *id.* at 20.

150. *Id.*

151. *Payroll Cards: An Innovative Product*, *supra* note 12, at 5. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 21. See also PAYMENT CARDS AND THE UNBANKED: PROSPECTS AND CHALLENGES, *supra* note 12, at 15 (discussing the popularity among Hispanic immigrants in the United States of cards that allow remittance of funds to foreign countries).

152. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12; PAYMENT CARDS AND THE UNBANKED: PROSPECTS AND CHALLENGES, *supra* note 12, at 16.

153. See FEDERAL RESERVE BANK OF NEW YORK, *supra* note 58 (“[A] reloadable multipurpose card may provide a level of functionality equal to or better than a traditional check account . . . .”); *supra* notes 149-52 and accompanying text.

154. See *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372 (noting that the nonbank program providers, or nonbank card marketing companies, establish their own bank accounts to hold customers’ stored value funds). It is assumed that traditional bank accounts are listed under the customer’s name.

In arrangements where the bank or credit card company issues an open-loop stored value card directly to the customer, the bank or credit card company may list the account holding the funds under the customer's name, similar to a normal bank account.<sup>155</sup> In this scenario, it has been reported that many banks and credit card companies elect to treat the accounts like their traditional accounts and follow customer identification regulations,<sup>156</sup> despite having no formal obligation to do so.<sup>157</sup> In arrangements where a nonbank card marketing company issues the card to the customer, the nonbank card marketing company typically deposits the funds into a bank account listed under its own name.<sup>158</sup> The bank account may either pool many purchasers' funds together or contain a series of sub-accounts.<sup>159</sup> Although many of these nonbank card marketing companies now collect some form of customer identification to purchase cards, they may have no regulatory obligation to do so and have no regulatory direction about what information to collect.<sup>160</sup> It could be argued that this business model, while offering similar functionality to a traditional bank account, produces even more money laundering risk because both

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155. See *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 373-74 (discussing the functionality of two types of stored value cards issued directly by banks, with the necessary implication that the bank deals directly with the customer).

156. Zindler, *supra* note 10, at 5.

157. See OCC Advisory Letter 2004-6, *supra* note 18 (acknowledging that the joint regulation implementing Section 326 does not currently apply to payroll cards and other stored value cards by describing the situation as "unsettled," but recommending that financial institutions comply with it nonetheless in order protect against "reputation risk and future compliance risk"). The advisory letter focuses on payroll cards but expressly states that it also "provides useful guidance with respect to other forms of stored value cards." *Id.* at n.3.

158. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 22; *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372.

159. MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 22; *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372.

160. If the company issues, sells, or redeems travelers' checks, money orders or stored value in an amount of \$1,000 or less per customer, per day, the company will have no regulatory obligation to verify the customer's identity. 31 CFR § 103.11(uu) (2006). If the amount is greater than \$1,000 per customer, per day, the company will be obligated by regulation to verify the customer's identity, but the applicable regulation specifies no further requirements for verifying identity. § 103.125(d)(1)(i)(A).

the individual card purchaser's identity *and* the patterns of individual activity are shielded from the bank.<sup>161</sup>

Because open-loop stored value cards and traditional bank accounts use similar business models and offer users virtually the same functionality in managing and moving money, they also produce the same risks of money laundering.<sup>162</sup> Therefore, open-loop stored value cards should also be subject to the joint regulation implementing Section 326.

C. *Open-loop Stored Value Cards Come Within the Statutory Purpose of Section 326*

The statutory purpose of Section 326 is to "facilitate the prevention, detection, and prosecution of international money laundering and the financing of terrorism."<sup>163</sup> It aims to do so by directing the Secretary of the Treasury to issue regulations requiring a wide variety of financial institutions to verify the identity of their customers.<sup>164</sup> This statute's purpose is not limited to addressing money laundering and terrorist financing only in certain business models, such as traditional bank accounts; rather, the statute's expansive definition of financial institutions to which it applies<sup>165</sup> demonstrates that Congress intended to pursue its purpose in many different financial business models, including open-loop stored value business models.

The BSA's broad definition of financial institution shows that Section 326 seeks to focus on the types of business models and products offered by at least two of the parties typically present in stored value business relationships: banks<sup>166</sup> and credit card companies.<sup>167</sup> Further, while nonbank card marketing companies

161. See MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 22.

162. See *supra* notes 147-61 and accompanying text. See also Zindler, *supra* note 10 (quoting a former FinCEN official who said of open-loop stored value cards and their risk of criminal use: "If it's easy to use, it's easy to abuse.").

163. Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25,090, 25,090 (proposed May 9, 2003) (codified in scattered parts of 12 C.F.R. and 31 C.F.R.).

164. USA PATRIOT Act § 326, 31 U.S.C.A. § 5318(l) (2002).

165. See 31 U.S.C. § 5312(a)(2) (2000).

166. § 5312(a)(2)(A)-(D).

167. § 5312(a)(2)(L).



are not expressly included in the statute's definition of financial institution, they could reasonably fall under provisions in the definition allowing the Secretary to classify as a financial institution "any business or agency which engages in any activity . . . which is similar to, related to, or a substitute for any activity in which any business [otherwise defined in the statute as a financial institution] is authorized to engage; or . . . any other business . . . whose cash transactions have a high degree of usefulness in criminal, tax or regulatory matters."<sup>168</sup> Considering open-loop stored value cards' functional and risk similarities to credit cards and traditional bank accounts tied to ATM or debit cards,<sup>169</sup> the Secretary should classify nonbank card marketing companies within this definition of financial institution.

Despite the fact that the Secretary of the Treasury, to this point, has used only a portion of the broad Section 326 statutory authority in issuing the joint customer identification regulation,<sup>170</sup> the Section 326 statute clearly intends to encompass the business models developed to support open-loop stored value cards.<sup>171</sup> Thus, the Section 326 joint regulation should be expanded to apply to open-loop stored value cards.

*D. Other Regulations Have Been Revised to Apply to Stored Value Cards*

The Board of Governors of the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) recently either revised or proposed to revise a regulation to cover certain stored value cards that cause risk to their respective statute's purpose.<sup>172</sup>

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168. § 5312(a)(2)(Y),(Z).

169. See *supra* notes 146-62 and accompanying text.

170. Compare USA PATRIOT Act § 326, 31 U.S.C.A. § 5318(l) (2002) (giving the Secretary of the Treasury a statutory directive to prescribe regulations requiring a broad range of financial institutions to verify the identity of their customers), with 31 C.F.R. § 103.121 (2006) (customer identification regulation only for banks, savings associations, credit unions and certain similar organizations); § 103.122 (2006) (broker-dealers); § 103.123 (2006) (futures commissions merchants and introducing brokers); § 103.131 (2006) (mutual funds); § 103.125 (2006) (money services businesses).

171. See *supra* notes 163-69 and accompanying text.

172. Regulation E, 71 Fed. Reg. 51,437 (Aug. 30, 2006) (to be codified at 12 C.F.R. pt. 205) (providing that Regulation E covers payroll card accounts that are

Although the regulators in each situation stressed that the individual purpose and nature of each regulation should caution against using their decisions as guidance in determining the applicability of other laws (including Section 326) to stored value cards,<sup>173</sup> the reasoning behind their decisions can nevertheless provide some direction.

In 2006, the Board of Governors of the Federal Reserve issued a final rule amending its Regulation E, which implements the Electronic Funds Transfer Act,<sup>174</sup> to expand the regulation's definition of "account" to include payroll card accounts.<sup>175</sup> The regulation's purpose is to provide consumer protection related to electronic funds transfer (EFT) transactions involving consumer accounts.<sup>176</sup> Specifically, the regulation provides for "disclosure of terms and conditions of an EFT service, documentation, . . . limitations on consumer liability . . . procedures for error resolution . . . and [restrictions on] the unsolicited issuance of ATM cards and other access devices."<sup>177</sup> The Board elected to bring payroll card accounts within the coverage of Regulation E "whether the account is operated or managed by the employer, a third-party payroll processor, or a depository institution."<sup>178</sup>

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established directly or indirectly through an employer, and to which transfers of the consumer's salary, wages, or other employee compensation are made on a recurring basis); Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access Mechanisms, 70 Fed. Reg. 45571 (proposed Aug. 8, 2005) (to be codified at 12 C.F.R. pt. 330.5(c)) (clarifying the insurance coverage of funds subject to transfer or withdrawal through the use of stored value cards and other nontraditional access mechanisms).

173. Regulation E, 71 Fed. Reg. at 51,447 ("The definition of 'account' as amended by the final rule does not affect the treatment of payroll card accounts under other laws. This final rule is intended only to address coverage issues under Regulation E."); Deposit Insurance Coverage, 70 Fed. Reg. at 45,575 ("[Other] laws and regulations . . . do not incorporate the definition of 'deposit' in the Federal Deposit Insurance Act. Therefore, the FDIC's interpretation of 'deposit' does not necessarily determine the applicability of [other] laws and regulations.").

174. Electronic Fund Transfer Act, Pub. L. No. 95-630, 92 Stat. 3728 (1978) (codified as amended at 15 U.S.C. §§ a-r (2000)).

175. Regulation E, 71 Fed. Reg. 51,437.

176. Regulation E, 12 C.F.R. § 205.1(b) (2006).

177. Regulation E, 71 Fed. Reg. at 51,438.

178. *Id.* at 51,439. The regulation also applies "whether the underlying funds are held in individual employee accounts or in a pooled account with some form of "subaccounting" maintained by a depository institution (or by a third party) to enable a determination of the amounts of money owed or attributed to particular employees." *Id.* at 51,440. The Board stated that "[t]his approach assures uniform

However, the Board declined to extend full Regulation E coverage to general spending reloadable cards that could be used for payroll or other general spending purposes.<sup>179</sup> The Board distinguished between payroll cards and general spending cards by reasoning that the latter “may only be used for limited purposes or on a short-term basis, and . . . may hold minimal funds,” whereas payroll cards have a greater likelihood of “serv[ing] as a consumer’s principal transaction account and hold[ing] significant funds for an extended period of time.”<sup>180</sup> The Board felt that consumers holding general spending cards would “derive little benefit” compared to the issuer’s costs of compliance.<sup>181</sup> Thus, the Board expanded Regulation E’s definition of “account” to include only products bearing risk to its specific regulatory purpose, and not those where it felt the risk was minimal.

The FDIC also recently proposed to update a regulation in order to address stored value cards.<sup>182</sup> The FDIC follows the statutory definition of the term “deposit” set forth in the Federal Deposit Insurance Act (FDI Act).<sup>183</sup> The purpose of the FDIC is to “preserve[] and promote[] public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions . . . .”<sup>184</sup> In 2005, the FDIC issued a proposed rule that would expand the regulatory definition of “deposit” to include “funds subject to transfer or withdrawal solely through the use of nontraditional access mechanisms, including cards, codes, computers or other electronic means, to the extent that such mechanisms provide access to funds received and held by an insured depository institution for payment to others.”<sup>185</sup> However,

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application and minimizes potential circumvention of the rule.” *Id.* at 51,440.

179. *Id.* at 51,441. The regulation also does not apply to “gift cards issued by merchants that can be used to purchase items in the merchant’s store.” *Id.* at 51,441.

180. Regulation E, 71 Fed. Reg. at 51,441.

181. *Id.* at 51,441.

182. Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access Mechanisms, 70 Fed. Reg. 45,571 (proposed Aug. 8, 2005) (to be codified at 12 C.F.R. pt. 330.5(c)).

183. Federal Deposit Insurance Act, 64 Stat. 873 (codified at 12 U.S.C. § 1813(l) (2000)).

184. Federal Deposit Insurance Corporation, <http://www.fdic.gov/about/learn/symbol/index.html> (last visited Jan. 12, 2007).

185. Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access Mechanisms, 70 Fed. Reg. at 45,578. The FDIC first included stored value

one major question raised in this rulemaking was: Who should be the beneficiary of insurance on stored value funds?<sup>186</sup> Noting that stored value funds located in a bank account may be placed there by a different party (e.g., an employer or nonbank card marketing company, or the “first party”) than the stored value cardholder (e.g., an employee or customer), the FDIC proposed to extend insurance only to the first party, unless “(A) the account records of the insured depository institution reflect the fact that the first party is not the owner of the funds; and (B) either the first party or the depository institution (or an agent on behalf of the first party or the depository institution) maintains records reflecting the identities of the persons holding the access mechanisms and the amount payable to each such person.”<sup>187</sup>

In this way, the FDIC proposed rule provides little guidance about whether the Section 326 joint regulation should be amended to require banks to identify all stored value cardholders, regardless of whose name is on the bank account. The FDIC proposed rule merely relies on banks’ existing customer identification procedures to decide which party should be the beneficiary of deposit insurance, rather than extending insurance all the way to the cardholder in all circumstances.<sup>188</sup> However, the FDIC’s decision to insure all stored value funds in general, regardless of the beneficiary, represents the expansion of a statute to cover products bearing risk to the statute’s specific purpose.<sup>189</sup> Whether funds in an account are owned by the cardholder or the party that placed the funds there, they are all subject to the risk of

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funds located at a depository institution within the definition of “deposit” in 1996. *Id.* at 45,572. In doing so, it adopted a four-part regulatory framework for stored value business models, taking into account the identity of the funds’ owner and the accounting method used by the depository institution, among other things. *Id.* at 45,572-73. In issuing the new proposed rule, the FDIC acknowledged that the evolution of stored value cards and their capabilities has blurred some lines within its regulatory framework and necessitated a revised rule. *Id.* at 45,573.

186. *See* Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access Mechanisms, 70 Fed. Reg. at 45,577.

187. *Id.* at 45,577-78.

188. *See id.*

189. *See supra* note 184 and accompanying text (explaining the statutory purpose of the FDIC).

insolvency by the financial institution holding them, a risk that would threaten public confidence in the U.S. financial system.<sup>190</sup>

The essence of the reasoning behind the decisions of both the Federal Reserve Board of Governors and FDIC translates well into the context of Section 326 regulation. Both groups tailored their respective regulation's definition of "account" or "deposit" to include only stored value cards that bear risk to their respective regulatory purpose.<sup>191</sup> Moreover, both the Board of Governors and FDIC expressly stated that their definitions of "account" and "deposit" were specific to each regulation's purpose and cautioned that they should not be applied or interpreted in the context of other regulations.<sup>192</sup> The Secretary of the Treasury, in consultation with the other issuing agencies, should take a similar individualized approach in amending the Section 326 joint regulation and recognize that open-loop stored value cards – regardless of the precise business model used – pose significant risk to the regulation's anti-money laundering and terrorist financing purpose. Thus, open-loop stored value cards should be subject to the Section 326 joint regulation.

#### V. ISSUES TO BE ADDRESSED IN APPLYING THE SECTION 326 JOINT REGULATION TO OPEN-LOOP STORED VALUE CARDS

##### A. *Which Party Should Bear the Responsibility for Customer Identification?*

Should the Secretary of Treasury and the other issuing agencies elect to expand the Section 326 joint regulation to apply to open-loop stored value cards, they will face the practical issue of how to obtain the customer identification information. Regulators could give final responsibility for customer identification to the

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190. See Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access Mechanisms, 70 Fed. Reg. at 45,578-79 ("Arguably, the form of the access mechanism is unimportant. Whether the mechanism is traditional or nontraditional, the access mechanism is merely a device for withdrawing or transferring the underlying money. The important thing is the underlying money. The receipt of money by the bank distinguishes a 'deposit' liability from a 'non-deposit' liability.").

191. See *supra* notes 179-86 and accompanying text.

192. See *supra* note 173.

bank holding the underlying stored value funds or to the party that sells or issues the product to the consumer (which may be the bank or a nonbank card marketing company).<sup>193</sup>

### 1. Give Customer Identification Responsibility to Banks

To give final customer identification responsibility to the bank holding the underlying stored value funds, regulators would have to expand the Section 326 joint regulation's definition of "account" to include all open-loop stored value cards, whether issued or sold by the bank or another party.<sup>194</sup>

Giving banks the responsibility to verify the identity of the owners of all open-loop stored value funds in its accounts would allow banks to retain ultimate control over access to global payment networks<sup>195</sup> and make use of their experience with customer identification procedures and existing relationships with financial regulators.<sup>196</sup> Vesting ultimate responsibility in banks would also, however, raise the difficult prospect of requiring them to verify the identity of each open-loop stored value card holder whose funds may reside in the bank account of a nonbank card marketing company.<sup>197</sup> Further complicating this scenario is the

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193. See FURLETTI, *supra* note 13, at 12. Giving final customer identification responsibility for open-loop stored value card to banks or nonbank card marketing companies would be more prudent than giving it solely to credit card companies because of the possibility of stored value card products – like some payroll cards – that would not be affiliated with a major credit card payment network yet still have access to banking networks via the funds' presence in a bank account. See *supra* notes 55-63 and accompanying text (describing payroll cards not affiliated with a credit card company).

194. See 31 C.F.R. § 103.121(a) (2006). The statutes granting regulatory authority – Section 326 and the BSA – do not expressly define the term "account." See USA PATRIOT Act § 326, 31 U.S.C.A. § 5318(l) (2002); Bank Secrecy Act, Pub. L. No. 91-508, 84 Stat. 1114 (codified as amended in scattered parts of 5 U.S.C.A., 7 U.S.C.A., 12 U.S.C.A., 15 U.S.C.A., 49 U.S.C.A.).

195. See MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 20 n.43 (noting that open-loop stored value cards can be used in global debit [POS] and ATM payment networks).

196. See generally 31 C.F.R. § 103.121 (2006) (imposing customer identification requirements on banks and certain other financial institutions).

197. See *Prepaid Cards: An Important Innovation in Financial Services*, *supra* note 27, at 372 (noting that nonbank program providers, or nonbank card marketing companies, establish their own bank accounts to hold customers' stored value funds and these accounts may pool many customers' funds together).

fact that many nonbank card marketing companies use other agents to sell cards to consumers, which could require banks to work through two different parties to discover customers' information.<sup>198</sup> This approach could add a significant burden to financial institutions.

To ease this burden, regulators could interpret the "reliance provision" of Section 326<sup>199</sup> to allow banks to rely, in appropriate circumstances, on nonbank card marketing companies to perform part or all of the CIP.<sup>200</sup> The provision currently requires a relied-upon financial institution to enter into a contract with the bank certifying annually that it has implemented the bank's AML program and that it, or its agent, will perform the specified requirements of the bank's CIP.<sup>201</sup> If this requirement is satisfied, and the reliance is deemed reasonable, then the bank is not held responsible for any failure of the relied-upon financial institution.<sup>202</sup>

Interestingly, a version of this reliance approach appears to be gaining traction in the marketplace even in the absence of any regulatory interpretation promoting it.<sup>203</sup> Credit card companies have reportedly begun relying on nonbank card marketing companies that sell cards granting access to their networks to perform some customer identification procedures that are part of the credit card companies' AML programs.<sup>204</sup> However, since the regulation requiring credit card companies to implement such AML programs does not specifically mention the possibility of

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198. *See id.*

199. *See* 31 C.F.R. § 103.121(b)(6).

200. To allow this reliance, regulators would have to interpret the definition of "financial institution" to include nonbank card marketing companies. *See* § 103.121 (a)(5); 31 U.S.C. § 5312 (2000). Such an interpretation may be reasonable. *See supra* note 104 and accompanying text (noting that the BSA's definition of financial institution could reasonably apply to nonbank card marketing companies through provision (Y), or perhaps (K) or (Z)).

201. Customer Identification Programs, for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25,090, 25,104 (proposed May 9, 2003) (codified in scattered parts of 12 C.F.R and 31 C.F.R.).

202. *Id.*

203. *See supra* notes 86-87 and accompanying text.

204. *See* JACOB, *supra* note 28, at 5 (stating that Visa and MasterCard now require customer identification for cards using their networks); MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12 (stating similar).

reliance on an outside party,<sup>205</sup> it is unclear whether the credit card company may shift final responsibility for the procedures to the nonbank card marketing company as is possible through the reliance provision.<sup>206</sup>

## 2. Give Customer Identification Responsibility to the Party that Sells/Issues the Product to the Customer

To give final customer identification responsibility to the party that sells the open-loop stored value product to the customer, regulators would again have to expand the Section 326 joint regulation's definition of "account" to include open-loop stored value cards, whether issued or sold by the bank or another party.<sup>207</sup> Additionally, the Secretary of the Treasury would have to interpret nonbank card marketing companies to be financial institutions under the BSA<sup>208</sup> and regulators would then have to expand the regulation's list of organizations to which it applies to include nonbank card marketing companies.<sup>209</sup> If these changes were made, the regulation would apply to whichever organization – the bank or the nonbank card marketing company – opened the stored value account for the customer.<sup>210</sup>

In this scenario, banks would still be required to perform customer identification procedures on open-loop stored value cards they sell or issue directly to customers, but nonbank card marketing companies would bear responsibility for those they sell or issue to customers.<sup>211</sup> This would logically represent a smaller obligation on banks. However, this would also bring a whole new

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205. See 31 C.F.R. § 103.135 (2006).

206. See *supra* notes 101-02 and accompanying text.

207. See § 103.121(a)(1).

208. The BSA does not expressly include nonbank card marketing companies within the definition of financial institution. See 31 U.S.C. § 5312(a)(2) (2000). However, such an interpretation may be reasonable. See *supra* note 104 and accompanying text. Congress gave the Secretary of the Treasury the authority to declare them as such through regulation. See § 5312(a)(2)(Y).

209. See 31 C.F.R. § 103.121(a)(2) (2006).

210. See § 103.121.

211. See *supra* notes 82, 84 and accompanying text (explaining that, in some instances, banks sell or issue cards directly to customers and, in other instances, nonbank card marketing companies sell or issue cards directly to customers).



set of companies under the authority of financial regulators and could, for example, raise questions about whether these nonbank companies are engaged in “deposit taking” or “branch banking” in violation of federal and state banking laws.<sup>212</sup> The ramifications of such a scenario could be complex.<sup>213</sup>

## VI. CONCLUSION

The growth of the stored value card market over the past few years has been immense.<sup>214</sup> Further, the evolution of stored value cards has been swift and has resulted in multiple offerings in the marketplace, each with its own unique operational logistics.<sup>215</sup> Up to now, as with any nascent business, regulators have faced the dilemma of whether to enact regulations in order to reduce risk or to allow product innovation to continue to a point where the market’s viability is established, particular operational risks have become prevalent and any future regulation will be focused and relevant.<sup>216</sup> Any attempts to regulate these products to this point would have been akin to aiming at a moving target.

Now the time has come to address stored value cards with pertinent anti-money laundering regulations. The stored value card market is now well established as a useful financial alternative for a large segment of consumers, as well as a profitable offering for participating businesses.<sup>217</sup> The range of products offered has evolved to the point where operational functionality and risks – particularly those related to open-loop stored value cards – have become abundantly clear.<sup>218</sup> Although any regulation of open-loop stored value cards could cause a complex reshuffling of roles and responsibilities in the stored value marketplace, the significant risk

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212. Judith Rinearson, *Prepaid Cards at a Crossroads*, S&P’S THE REVIEW OF BANKING AND FINANCIAL SERVICES, Jan. 1, 2005, 1, at 6-10.

213. Other potential ramifications of such a scenario are beyond the scope of this Note.

214. Zindler, *supra* note 10 (citing figures from Mercator Advisory Group stating that consumers spent \$400 million using prepaid cards in 2003, \$1.42 billion in 2004 and, as of late 2005, were projected to spend \$3.62 billion in 2005).

215. See JACOB, *supra* note 28, at 4.

216. See Rinearson, *supra* note 212, at 11.

217. Rinearson, *supra* note 11, at 41.

218. See MONEY LAUNDERING THREAT ASSESSMENT, *supra* note 12, at 21.

demands regulation. We demand to know the identity of everyone else using our nation's banking system: why not stored value card users?

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