



## The Credit CARD Act of 2009 and Prepaid Cards

Philip Keitel\*

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*Recently enacted federal legislation contains a number of provisions that will affect the prepaid card industry. This note highlights some of these provisions, discusses how they might shape the prepaid card industry, and outlines the debate over whether prepaid cards should be defined as “monetary instruments” under federal law.*

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On May 22, President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act of 2009.<sup>1</sup> Although the act is named for its regulation of credit card issuing practices, several provisions focus not on credit cards but on certain prepaid cards. This note discusses these provisions and what they might mean for segments of the prepaid card industry. It also looks at how a part of the act relates to an ongoing debate about whether prepaid cards should be defined as “monetary instruments” under federal law.

### **Title IV of the Act**

Title IV of the act could have a significant impact on segments of the prepaid card industry. For those cards that fall under the act’s definitions of “general-use prepaid card,”<sup>2</sup> “gift certificate,”<sup>3</sup> and “store gift card,”<sup>4</sup> Title IV

limits fees and expiration dates. (Several other common types of prepaid cards, such as reloadable cards that are not marketed as gift cards, telephone cards, cards not marketed to the general public, and loyalty, award, or promotional cards, are not covered by the provisions of Title IV.) In addition, Title IV sets forth disclosure requirements necessary to implement expiration practices and charge fees addressed by Title IV. Finally, Title IV assigns a number of responsibilities to the Federal Reserve Board of Governors regarding the regulation of prepaid cards. This section first addresses Title IV’s limitations on fees and expiration practices, then turns to the disclosure requirements, and finally, notes the Board’s responsibilities.

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### *Limitations on Fees*

Title IV restricts when dormancy fees, inactivity fees, or service fees may be charged by prohibiting the assessment of *any* of these fees *unless* certain procedures are followed.<sup>5</sup> In defining the term service fee, Title IV excludes a one-time issuance fee for a general-use prepaid card. This type of fee is, therefore, not subject to Title IV's limitations. Additionally, gift certificates for which no money or other value has been exchanged and which are issued as part of an award, loyalty, or promotional program are excluded from the prohibition on fees.

For prepaid cards subject to Title IV, certain substantive limitations on charging dormancy, inactivity, or service fees apply. First, Title IV stipulates that no more than one fee is allowed per month. Second, these fees may be charged only if there has been no activity with respect to the card or certificate in the 12 months prior to the date on which the fee or charge is assessed. Last, certain disclosures (discussed below) must be provided.

### *Limitations on Expiration Dates*

Title IV prohibits expiration dates unless the terms are clearly stated and the expiration date is no earlier than five years after (1) the issuance of the gift certificate or (2) the date funds were last loaded to a store gift card or general-use prepaid card.

### *Disclosure Requirements*

It is important to highlight that the failure to disclose fees, charges, or expiration dates in the manner prescribed under Title IV makes charging these fees or imposing expiration dates illegal. Specifically, Title IV states that "it shall be unlawful for any person to impose a dormancy fee, an inactivity charge or fee, or a service fee with respect to a gift certificate, store gift card, or general-use prepaid card" and that it shall be unlawful to sell any of the same if they

are "subject to an expiration date," unless disclosure requirements are satisfied.<sup>6</sup>

To charge a dormancy, inactivity, or service fee, the issuer must inform the purchaser of the fee before the card is purchased. This pre-purchase disclosure must take place regardless of whether the purchase is completed in person, over the Internet, or over the phone. In addition, the card or certificate itself must clearly state that a fee may be charged, the amount of the fee, and how often it may be assessed, and that a fee may be charged for inactivity.

If a card is subject to an expiration date, Title IV requires that the terms of expiration be clearly and conspicuously stated.

### *The Role of the Federal Reserve*

The Federal Reserve Board of Governors, which at present regulates only payroll products under the Electronic Fund Transfer Act and Regulation E,<sup>7</sup> is responsible for prescribing regulations to implement this legislation. Examples of tasks that the Board is charged with under Title IV include defining loyalty, award, or promotional gift cards for the purpose of excluding them from the definitions of covered prepaid instruments, and potentially enacting additional requirements that must be met in order for a dormancy, service, or inactivity fee to be charged.

Overall, Title IV may affect the prepaid card industry in a number of ways. For many prepaid card issuers, changes may have to be made to how and when fees are charged, when cards expire, and the disclosures provided at point of sale. For some issuers, Title IV's fee limitations may require some alteration of fee models employed by many large prepaid businesses. Fee structures may shift from primarily after-purchase models to up-front models or to a

mixed model where both up-front fees and properly structured fees are assessed. However, it is important to note that many large issuers of gift cards have eliminated fees and expiration dates altogether. Nonetheless, the requirements set forth by Title IV may have some impact on issuers' practices with respect to other prepaid products, such as how fees and expiration dates are disclosed.

### **Title V, Section 503 of the Act and the Monetary Instrument Debate**

Title V, section 503 of the act requires the Treasury Department to “issue regulations in final form implementing the Bank Secrecy Act, regarding the sale, issuance, redemption, or international transport of stored value, including stored value cards,” within 270 days from the date of enactment. In addition, the section notes that the Treasury Department, in crafting these regulations, “may include reporting requirements pursuant to section 5316 of title 31, United States Code.”<sup>8</sup> This is a federal law that sets forth reporting requirements for individuals receiving certain monetary instruments or transporting monetary instruments of a certain value into or out of the country. If prepaid cards become subject to this law and are more broadly classified as monetary instruments, banks or their agents would be required to gather information about individuals purchasing card(s) worth more than \$3000,<sup>9</sup> and consumers would be required to file a Report of International Transportation of Currency or Monetary Instrument (CMIR) when crossing the border with, or sending across the border, a prepaid card or group of cards worth \$10,000 or more.<sup>10</sup>

Defining stored-value cards — or prepaid cards as they are referred to in this note — as monetary instruments is not a new idea to Congress. In fact, this idea was raised in 2007 by

Senator Charles Grassley when he proposed amending the Combating Money Laundering and Terrorist Financing Act of 2007 to define prepaid cards as monetary instruments.<sup>11</sup> More recently, in March, Arizona attorney general Terry Goddard testified before the Senate Judiciary Subcommittee on Crime and Drugs and the Senate Caucus on International Narcotics Control that law enforcement agencies “need legal and investigative tools specifically addressing such new developments as stored value cards.”<sup>12</sup> Goddard argued that to combat criminal activity these cards should be defined as monetary instruments in federal law and that law enforcement agencies should be allowed to access cardholders' identities, track transactions, and identify patterns of suspicious activity. Later in March, related to the debate over whether prepaid cards should be defined as monetary instruments under federal law, Senators Susan Collins and Joseph Lieberman questioned senior officials in the Obama administration on what they were doing to prevent criminals from using prepaid cards to launder money, questioning prompted by ongoing violence in Mexican towns near the U.S. border.<sup>13</sup>

Along with recent congressional inquiry into the matter, there is an ongoing debate over whether classifying prepaid cards as monetary instruments will effectively reduce the use of prepaid cards by criminals or whether this approach will instead result in regulations that are difficult to implement.<sup>14</sup> Supporters of defining prepaid cards as monetary instruments argue that observed criminal use of prepaid cards and seizure of cards at border crossings indicate that indeed these cards are used for nefarious purposes and that regulatory change is necessary to combat modern criminal use of prepaid cards.<sup>15</sup> Opponents make the case that imposing new regulations and reporting requirements may have a chilling effect on the development of the prepaid market: New

products will not be brought to the market, issuers may eliminate many types of programs, and there may be deleterious effects for the industry as a whole.<sup>16</sup> Prepaid industry analysts note that even if federal agents are able to seize certain cards being sent across the border, it will be difficult for those agents to ascertain the value of funds accessible via those cards because the value is not noted on the cards themselves but rather is maintained by the bank holding the underlying funds.<sup>17</sup> Similarly, consumers may not generally know the exact balance of a prepaid card account at a particular point in time. This may lead to erroneous reporting on CMIRs and may represent an obstacle to implementing reporting requirements that ask consumers to record the value of the prepaid cards they carry.

Another potential obstacle comes from state jurisprudence that provides to individuals a right of privacy in their bank records.<sup>18</sup> Essentially, federal agents may not be able to force a bank to divulge the balance of an underlying account without a warrant or subpoena. Therefore, should prepaid cards be subject to reporting requirements, the ability to verify the accuracy of an individual's report and seize a card or

cards could be hampered. Technology and partnerships with industry may enable law enforcement agents to make balance inquiries or to seek transaction authorizations with regard to particular cards, thus obtaining an approximation of the true value of underlying funds; however, the question remains as to whether, in certain instances, these inquiries into a person's banking records require a warrant or subpoena.<sup>19</sup> On the other hand, the ability to seize some cards and ascertain the amounts accessible by using the card may be a pragmatic tool in fighting criminals' use of prepaid cards.

The tremendous popularity of prepaid card products among consumers and criminals alike has drawn Congress's attention to these products and to the prepaid card industry. The prepaid provisions of the Credit CARD Act of 2009 represent the first time Congress has acted to protect consumers who use prepaid cards. As the market for this particular payment instrument continues to develop, the industry, consumers, and regulators will inevitably need to address new and unanticipated challenges. Nonetheless, including these provisions in the act recognizes the increasing role this type of payment card plays in today's society.

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\* Payment Cards Center, Federal Reserve Bank of Philadelphia, Ten Independence Mall, Philadelphia, PA 19106. E-mail: philip.keitel@phil.frb.org. The views expressed here are those of the author and not necessarily those of the Federal Reserve Bank of Philadelphia, the Federal Reserve System, or the Federal Reserve Board of Governors.

<sup>1</sup> The Credit Card Accountability Responsibility and Disclosure Act of 2009; full text is available at: [www.creditcardreform.org/pdf/credit-card-bill-2009.pdf](http://www.creditcardreform.org/pdf/credit-card-bill-2009.pdf).

<sup>2</sup> Section 915(a)(2)(A) defines a general-use prepaid card as "a card or other payment code or device issued by any person" and that is "redeemable at multiple, unaffiliated merchants or service providers, or automated teller machines"; "issued in a requested amount, whether or not that amount may, at the option of the issuer, be increased in value or reloaded if requested by the holder"; "purchased or loaded on a prepaid basis"; and "honored, upon presentation, by merchants for goods and services, or at automated teller machines."

<sup>3</sup> Section 915(a)(2)(B) defines a gift certificate as "an electronic promise" that is "redeemable at a single merchant or an unaffiliated group of merchants that share the same name, mark, or logo"; "issued in a specific amount that may not be increased or reloaded"; "purchased on a prepaid basis in exchange for payment"; and is "honored upon presentation by such single merchant or affiliated group of merchants for goods and services."

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<sup>4</sup> Section 915(a)(2)(C) defines a store gift card as “an electronic promise, plastic card, or other payment code or device” that is “redeemable at a single merchant or an affiliated group of merchants that share the same name, mark, or logo”; “issued in a specific amount, whether or not that amount may be increased in value or reloaded at the request of the holder”; “purchased on a prepaid basis in exchange for payment”; and “honored upon presentation by such single merchant or affiliated group of merchants for goods and services.”

<sup>5</sup> Emphasis added.

<sup>6</sup> See sections 915(b)(1) & (c)(1), and the subsequent exclusions/exceptions to each.

<sup>7</sup> See the Board of Governors press release announcing the extension of Regulation E coverage to payroll products (August 24, 2006), available at: [www.federalreserve.gov/newsevents/press/bcreg/20060824a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20060824a.htm) (accessed June 11, 2009).

<sup>8</sup> 31 U.S.C. § 5316 is a federal law that requires individuals who transport, mail, or ship monetary instruments into or out of the United State to file a Report of International Transportation of Currency or Monetary Instruments (CMIR) with the Financial Crimes Enforcement Network (FinCEN), a division of the Treasury Department.

<sup>9</sup> This includes both individual card purchases worth more than \$3000 and contemporaneous purchases by a single individual of prepaid cards that, in the aggregate, amount to more than \$3000 [31 - subtitle b – C.F.R. § 103.29(b)]. For information on banks’ reporting and recordkeeping requirements, see 31 U.S.C. § 5325; 31 - subtitle b – C.F.R. § 103.29(a).

<sup>10</sup> 31 U.S.C. § 5316(a); 31 - subtitle b – C.F.R. § 103.23(a).

<sup>11</sup> See Substituted Amendments to the Combating Money Laundering and Terrorist Financing Act of 2007, proposed by Senator Charles Grassley, at § 12 (2007), S. 1860 § 338 (2007), and H.R. 3156 § 338 (2007), for Congress’s previous consideration of this issue.

<sup>12</sup> See the testimony of Terry Goddard, attorney general of Arizona, before the Senate Judiciary Committee, Subcommittee on Crime and Drugs and the Senate Caucus on International Narcotics Control, entitled “Law Enforcement Responses to Mexican Drug Cartels,” (March 17, 2009), p. 9, available at: [www.azag.gov](http://www.azag.gov) (accessed April 14, 2009). See also Kiran Chetry, “Official: Drug Lords Using ‘Gift Cards’ to Smuggle Money,” and the interview with Terry Goddard (June 10, 2009), available at: [www.cnn.com](http://www.cnn.com) (accessed: June 16, 2009).

<sup>13</sup> See “Drug Cartels Cash in with Value Cards,” a radio story from Marketplace, by American Public Media (aired March 25, 2009), available at: [http://marketplace.publicradio.org/display/web/2009/03/25/pm\\_value\\_cards/](http://marketplace.publicradio.org/display/web/2009/03/25/pm_value_cards/). This story notes that the Senate wants to “close [the] loophole” on stored-value cards being used to launder money. See also Chris Strohm, “Senators Target Cards Used to Move Money into Mexico,” *CongressDaily*, (March 25, 2009), which details the link between this debate and a congressional hearing on a recent crime wave across the border from the U.S. in Mexico.

<sup>14</sup> Compare, for example, *Prepaid Stored Value Cards: A Potential Alternative to Traditional Money Laundering Methods*, U.S. Department of Justice National Drug Intelligence Agency, October 31, 2006, p. 7, which proposes that prepaid cards be defined as “monetary instruments” to allow law enforcement officers to, under certain circumstances, seize cards and so that law enforcement agents will generally know more about which cards are being carried, with Mark J. Furletti, “Why Prepaid Cards Should Not Be Classified as ‘Monetary Instruments’,” *Paybefore Update* (September 2007), pp. 1, 3-5, which notes numerous legal and operational obstacles that will make enforcing implementing regulations difficult or impractical.

<sup>15</sup> See the testimony of Terry Goddard, attorney general of Arizona, before the Senate Judiciary Committee (see endnote 12), and *Prepaid Stored Value Cards: A Potential Alternative to Traditional Money Laundering Methods* (see endnote 14).

<sup>16</sup> See “Why Prepaid Cards Should Not Be Classified as ‘Monetary Instruments’,” pp. 1, 3-5 (see endnote 14).

<sup>17</sup> See “Why Prepaid Cards Should Not Be Classified as ‘Monetary Instruments’,” pp. 1, 3-5 (see endnote 14).

<sup>18</sup> See, for example, American Civil Liberties Union of Washington State, *Personal Bank Records Are Private, Says Supreme Court* (Seattle: ACLU, 2007), p. 1; and *Commonwealth v. DeJohn*, 403 A.2d 1283 (Pa 1979), holding that Pennsylvania residents have a right of privacy in their bank records.

<sup>19</sup> See Courtney J. Linn, “Regulating the Cross-Border Movement of Prepaid Cards,” *Journal of Money Laundering Control*, 11: 2 (2008), pp. 146-71, which discusses one possible way that government agents could ascertain the funds accessible on a particular card, pp. 151, 155-157, and addresses privacy-related concerns, pp. 157-62.