

Comments of National Consumer Law Center¹

on behalf of its low income clients

and

Center for Responsible Lending²

Consumer Federation of America³

to

Consumer Financial Protection Bureau

on

Electronic Fund Transfers (Regulation E), 12 CFR Part 1005

General Use Reloadable Prepaid Cards

Advance Notice of Proposed Rulemaking

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¹ **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and policy advice on consumer law issues to attorneys, policymakers and consumer advocates across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including Consumer Banking and Payments Law, as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers.

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² **The Center for Responsible Lending (CRL)** is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund.

CRL joins these comments except for section III.B.2 on Regulation E modifications. CRL supports the principles discussed in that section but reserves judgment on the specific suggestions.

³ **Consumer Federation of America (CFA)** is a nonprofit association of some 300 national, state, and local pro-consumer organizations created in 1968 to represent the consumer interest through research, advocacy, and education.

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I. Introduction and Summary

Thank you for the opportunity to submit comments on the regulation of general purpose reloadable (GPR) prepaid cards. These comments are submitted by the National Consumer Law Center (on behalf of its low income clients), the Center for Responsible Lending, the Consumer Federation of America.

Prepaid cards are an important new financial product that holds the promise of expanding access to modern electronic transactions to millions of consumers. However, prepaid cards lack consumer protections and some have features that expose consumers to unnecessary dangers. We welcome the CFPB's intention of ensuring that these products are safe, useful and empowering.

The most important step that the CFPB can take to ensure that prepaid cards fulfill their promise, and to prevent unfair, deceptive or abusive practices, is to ensure that prepaid cards are true to their essence as a prepaid transaction product. **Overdraft and credit features must be prohibited on prepaid cards.**

Mixing credit and prepaid deposits undermines the integrity of the prepaid card market and the safety of the consumers who use the cards. "Prepaid" should mean prepaid. Prepaid cards users are vulnerable consumers, who want controls on overspending. Prepaid card credit features are promoted for large or unexpected expenses but designed to be used routinely, encouraging a cycle of debt – a practice that is especially pernicious since prepaid cards do not underwrite for ability to pay. . Banning overdraft fees and credit features will minimize account closures and protect access to transaction accounts. Back-end profits from overdraft fees and credit features undercut honest, up-front pricing and lead to an uneven playing field and race to the bottom. Banning overdraft fees on prepaid cards will implement the clear preference of Congress and create consistent rules for all players in the market.

Permitting credit features on prepaid cards will enable widespread evasion of consumer protection laws. Prepaid credit features will undo the elimination of rent-a-bank payday lending that was laboriously achieved a decade ago and be much more difficult to control if left to spread. Prepaid credit features are already being used to circumvent the law, but it is early enough to nip this trend in the bud. Credit on prepaid cards evades federal and state laws protecting public benefits and wages needed for necessities and protecting military service members. Prepaid cards with credit features are credit cards but escape TILA's credit card protections.

Permitting overdraft fees or other credit features on an opt-in basis will not protect prepaid cards users from the dangers of credit features or from unfair, deceptive or abusive practices. Opt-in has not worked for checking account overdraft fees and there is even less basis to rely on opt-in to protect prepaid card users. The CFPB can either have a clear rule

against overdraft fees and credit features on prepaid cards, or it can fight a losing battle on a billion fronts to chase after unfair, deceptive and abusive practices.

The CFPB has the authority to ban overdraft fees and credit features on prepaid cards. Such a ban is necessary to prevent unfair, deceptive or abusive practices, to carry out the purposes of the Electronic Funds Transfer Act and the Truth in Lending Act, and to carry out the CFPB's mandate to preserve access to safe financial products.

In addition to banning overdraft fees and other credit features, the CFPB should take several other measures to protect prepaid card users.

All GPR cards should be covered by Regulation E. Regulation E should cover cards used for health or other flexible spending programs, college or university cards, virtual prepaid cards offered through mobile payment systems, and prepaid cards used for needs-based benefits. The statutory exemption for electronic benefit transfer (EBT) systems should be limited to cards that operate on an EBT platform and not network-branded prepaid cards.

The CFPB should work with the Federal Reserve Board to develop **a common definition of "prepaid card,"** for purposes of both Regulation E and the interchange regulations, that does not encompass bank accounts but **does not prohibit bill payment features, transfers to savings, or remittances.**

Prepaid card users, like bank account customers, need access to statements and account information, as required under Regulation E. If any modifications are permitted, they should apply to only cards that meet certain qualifications and should not permit bank accounts to evade statement requirements or the E-Sign Act.

Any Regulation E modifications must improve upon the payroll card rules. Consumers should not be charged for balance inquiries, for electronic access to their accounts, or for ad hoc requests for paper statements. They should have the right to opt in to automatic monthly paper statements for a minimal fee no more than the cost of the statement, approximately \$1 per month. Consumers also need to be able to contact customer service when necessary for free. To prevent evasions of the conditions on modified rules, the CFPB should also clarify regular existing EFTA and E-Sign Act requirements for bank accounts.

In addition, to protect prepaid card users:

- Funds must carry **deposit insurance** and be safe from insolvency and impediments to access in case of issuer bankruptcy.
- Regulation E needs to be enhanced to ensure **merchant chargeback rights**, protection and error resolution for **deposits**, and **prompt processing** of transfers.

- **Certain fees should be discouraged, regulated or banned**, including fees designed to obscure pricing, information fees, penalty fees, and fees for exercising legal rights.

On the disclosure front, the CFPB should develop a **single price tag** reflecting the average monthly cost of the card by the actual consumers to whom the card is marketed, taking into account the myriad of ways that the issuer can manipulate or protect the consumer from incurring fees. **All fees should be disclosed in a standardized chart in a conspicuous location**, on the outside of the package when sold at retail, both pre- and post-sale.

The Bureau should **encourage and facilitate savings** on all GPR cards, including those offered by large banks, but stop unfair or deceptive products such as **inactivity fees** on savings accounts. The Bureau should be vigilant against deceptive claims about building credit given the **lack of evidence that reporting prepaid card transactions to credit bureaus builds a positive credit record**.

Consumers must have the choice whether to use a prepaid card for receipt of government benefits, school financial aid, or wages. The CFPB should clarify that consumers must be offered the clear and easy-to-exercise **choice of direct deposit to an account of their choosing before being given a prepaid card**.

Finally, in order to ensure that legal protections for prepaid cards are actually observed and enforced, the CFPB should **ban pre-dispute mandatory arbitration** on prepaid cards.

II. Prepaid Cards Should Not Have Overdraft Fees or Any Other Credit Features

The most important issue the CFPB must address is the use of prepaid cards as a dangerous credit product. Overdraft fees and credit features are dangerous to the consumers who use prepaid cards and are a means of evading credit laws. They should be completely banned on prepaid cards.

The CFPB and other regulators can spend the next decades chasing a cornucopia of unfair, deceptive and abusive practices, or the CFPB can adopt a clean rule that everyone can follow. Any other approach will eviscerate federal and state laws addressing predatory lending, undermine fair competition in the market, and harm the most vulnerable consumers.

A. Prepaid Credit Features are Already Appearing But It is Not Too Late to Stop Their Spread

The history of prepaid card credit features is not a pretty one. The cards have been used to circumvent state and federal laws, often in partnership with payday lenders.

Assertive action by the Office of Thrift Supervision stopped credit features from spreading for a period of time, and overdraft fees have been disappearing from mainstream cards. But there are still some prepaid cards on the market with disturbing overdraft fees or credit features.

Nonetheless, these cards are definitely the exception. The time is now to establish a clear rule banning overdraft fees and credit features on prepaid cards to protect prepaid card users and staunch evasions of consumer protection laws.

1. NetSpend iAdvance Line of Credit

A few years ago, the iAdvance line of credit was offered by Account Now on Netspend cards issued by Meta Bank. The line of credit was modeled after the Wells Fargo account advance product and cost \$2.50 per \$20 borrowed (or \$12.50 per \$100). This line of credit was a payday loan short and simple. It was an advance of pay or public benefits repayable in a lump sum in a short period of time at a triple digit annual rate. The only difference between this line of credit and a traditional payday loan was the slightly cheaper rate and a likely shorter repayment period (upon the next deposit, most likely in less than 14 days). These Netspend payday loans were offered on prepaid cards sold by payday lenders, online and by tax preparers. We believe that they were available to consumers throughout the country notwithstanding state usury or payday laws.

In 2010, the Office of Thrift Supervision shut down the Meta Bank iAdvance line of credit on the grounds that it was unfair or deceptive, and ordered the bank to pay restitution.⁴ The OTS did not detail the basis for its action, but it appears to be based on the lack of underwriting, the unaffordable repayment structure, and the repeat usage and debt trap that are the inevitable result of the payday loan model.⁵

The OTS action stopped the spread of prepaid card payday loans for a period of time. But they have been slowly returning to the market, perhaps encouraged by proposed guidance from the Office of the Comptroller of the Currency, which could be read to sanction account advance products, as discussed in section II.C.2 below.

⁴ In the matter of MetaBank, Order No. CN 11-25 (OTS July 15, 2011), available at <http://www.ots.treas.gov/files/enforcement/97744.pdf>. MetaBank was later ordered to pay \$4.8 million in restitution. The bank 8K SEC filing is available at <http://biz.yahoo.com/e/110718/cash8-k.html>.

⁵ OTS required MetaBank, among other requirements, to establish policies governing lending products, including subprime products, that include, “at a minimum, (i) comprehensive written underwriting standards for each type of sponsorship lending approved by the Board; (ii) a requirement that current and satisfactory credit information be obtained on each borrower prior to the granting of credit demonstrating the ability to repay; (iii) a requirement that the anticipated source of repayment for each borrower be documented in the loan file; (iv) establishment of reasonable, maximum debt (including any add-ons such as credit life, credit disability, force placed insurance and service contracts) to income ratios; (v) establishment of reasonable loan maturity terms, amortization periods, and loan renewal policies” Order to Cease and Desist, In the Matter of MetaBank, Storm Lake, Iowa, OTS Docket No. 05902, Order No.: CN 11-25 (effective July 15, 2011), available at <http://www.ots.treas.gov/files/enforcement/97744.pdf>.

2. CheckSmart/Urban Trust Bank Insight Card Payday Loans

The payday lender CheckSmart has been using prepaid cards to evade payday laws in at least two states, Arizona and Ohio, and probably others. CheckSmart stores are owned by Community Choice Financial, Inc., formerly known as Buckeye Check Cashing. The prepaid cards are provided by Insight Card Services, LLC (partially owned by Community Choice Financial officers), and are issued by Florida-based federally chartered Urban Trust Bank.⁶

CheckSmart's own card-based payday loans take two forms. The first form is styled as overdraft coverage. If the consumer opts in, transactions that exceed the card balance will be approved for an "overdraft protection service fee" of 15% of the negative balance (\$15 per \$100). The second form of prepaid card payday loan, which may have been recently discontinued,⁷ allowed consumers to get an advance of wages or public benefits for a "convenience transfer fee" of \$3.50 per \$28.50 advance (yielding \$25 net credit, for fees of \$14 per \$100) plus 35.9% interest. The loans require direct deposit of public benefits or wages to the prepaid card and are repaid by the next deposit, as soon as a day or two later.

The annual rate for a 14-day loan is 390% to 401%. These 400% loans are offered in states that have usury caps of 28% to 36%.

Though state laws should apply to CheckSmart's Insight prepaid card payday loans and to overdraft credit on other cards, states would face a number of challenges in asserting those laws. Providers might claim that the credit is offered by the bank issuer and thus is not subject to state interest rate caps. Providers may also claim that the fees are charged by the bank and state laws regulating those fees are preempted. Sorting out which party extends the credit, bears the risk of loss, and enjoys the profit from the fees is complicated. Providers may also claim that overdraft coverage is not a loan subject to state credit laws or that overdraft fees are not interest. They may structure other credit features with fees styled as load or other types of fees – like CheckSmart's "courtesy transfer fee" – that are purportedly not charged by the lender and not interest subject to state caps. States may be hesitant to undertake the extensive litigation and risk of adverse court decisions to take on these cards, especially given that prepaid card issuers may fall through the cracks of payday loan licensing requirements.

⁶ NCLC and other consumer groups recently sent a letter to the Office of the Comptroller of the Currency outlining the various legal issues posed by the prepaid cards and asking the OCC to stop Urban Trust Bank from issuing cards with credit features. Letter from NCLC et al. to OCC (May 3, 2012) (NCLC CheckSmart Ltr to OCC), available at http://www.nclc.org/images/pdf/high_cost_small_loans/ltr-urban-trust-occ.pdf.

⁷ A recent SEC filing indicates that CheckSmart may have ceased offering the line of credit, following publicity over NCLC's letter to the OCC. Form S-4, Community Choice Financial, Inc., U.S. Securities and Exchange Comm'n at 99, 110-111 (June 22, 2012), available at http://www.sec.gov/Archives/edgar/data/1528061/000110465912045258/a12-11068_7s4.htm. That filing reveals that the "third party" loans were purchased by another subsidiary of CheckSmart's parent company. *See id.* at 111.

3. Urban Trust Bank/Insight Tandem Money

A more recent arrangement between Urban Trust Bank, Insight Card Services, LLC (part owned by the payday lender CheckSmart) involves a line of credit and a linked savings account called Tandem Money.⁸ Borrowers are required to save \$20 per month to be able to access the credit line, which claims to lead to savings rather than borrowing over time. The savings requirement has some attractive aspects but it is complicated and not clear if it leads to real savings. The credit is deceptively expensive, with mandated automatic repayment that may violate Regulation E and could lead to a cycle of debt.

The credit and a linked savings account are offered by Premier Bank of Iowa but they dovetail with prepaid cards issued by Urban Trust Bank. Tandem Money offers payday loans at a rate of \$8 to \$10 per \$100 advanced.⁹ Funds are automatically repaid upon direct deposit. For a 10-day loan, the APR would be 292% to 365%.

The Terms and Fee Summary appears designed to confuse consumers about the difference between an advance fee and an APR and to hide the high cost of the credit. Because it is styled as an open-end line of credit, no APR is disclosed. The summary provides a tabular chart that mimics a credit card chart and lists the advance fee in percentage terms – 8.00% to 10.00% of the amount advanced – that look just like the APRs that would appear in a credit card chart.¹⁰ A modest-appearing percentage fee translates to a triple-digit APR when calculated on an annual basis.

The funds can be deposited either onto the Insight Prepaid Card described above¹¹ or a new prepaid card also issued by Urban Trust Bank, the Tandem Money MasterCard® Prepaid Card.¹² In theory, the funds can also be accessed by ACH transfer to a bank account or a wire remittance transfer. But Tandem Money delays access to the funds for five days if those options are selected, thereby steering consumers into prepaid card transfers.¹³

The Tandem Money advances are automatically repaid upon direct deposit to the prepaid card. For new customers, the loans are single payment loans for which automatic repayment is

⁸ <http://insightcards.com/abouttandemmoney>.

⁹ See TandemMoney Terms and Fee Summary, available at http://www.insightcards.com/images/uploads/120502_FeeSummary.pdf (last visited 7/23/12).

¹⁰ See TandemMoney Terms and Fee Summary.

¹¹ <http://insightcards.com/abouttandemmoney>.

¹² <https://mytandemmoneycard.com/index.aspx> (last visited July 16, 2012).

¹³ See Your TandemMoney Savings Account and Line of Credit Agreement § 2.8 (effective Jan. 2012) (TandemMoney T&C), available by clicking on the link for the terms and conditions within the Fee Summary, available at http://www.insightcards.com/images/uploads/120502_FeeSummary.pdf (last visited 7/23/12).

required.¹⁴ Customers who have had the prepaid card for at least seven consecutive direct deposits may be entitled to repay the loans in two to five payments.¹⁵

But Tandem Money still effectively requires automatic repayment. Automatic repayment appears to be the default method, used “unless Authorization revoked and \$50 Manual Payment Fee is paid.”¹⁶

The centerpiece of the Tandem Money is the savings feature. The credit line is only available if the consumer commits to save at least \$20 each month. Any borrowing comes from accumulated savings before drawing on credit, and any savings draw-downs must be replenished each month. The savings feature sounds attractive.

But the repayment obligations may exacerbate the cycle of debt. As soon as the consumer’s next deposit of wages or benefits comes in, a payment is taken off the top consisting of the initial loan, the associated fees, and repayment of the savings. Thus, the consumer likely has a huge income hole to fill the next month and needs to borrow again, just like a traditional payday loan. The ability to pay in installments for some consumers could mitigate this problem, depending on how it works in practice. But it remains a very expensive, triple-digit credit product.

Moreover, it is not clear if savings or borrowing is the real goal. After four months, if the consumer stops borrowing and also does not contribute additional savings, any savings accumulated start being depleted by a \$5 per month inactivity fee.

Because the Tandem Money line of credit is offered by a bank, it likely claims to be immune from state interest rate caps. But the prepaid card program manager Insight (part owned by the owners of the payday lender CheckSmart) promotes the line of credit on its website.¹⁷ It appears likely that Insight and/or CheckSmart has some arrangement to enjoy profits from the credit line, and perhaps even to repurchase the credit, as with the CheckSmart card described above. Consequently, the card may well be another vehicle for CheckSmart’s payday loan evasions.

4. SureCashXtra Tribal Prepaid Card Overdraft-Style Loans

The payday lender SureCashXtra offers loans at \$1.60 per \$10 (\$16 per \$100). The loans are repaid automatically upon the next direct deposit. If they follow the pattern of other loans repaid in that fashion and have an average 10-day term, the APR would be 584%. But no APR is disclosed on the website.

SureCashXtra claims that it is “a tribal lending entity wholly owned by the Chippewa Cree Tribe of the Rocky Boy’s Indian Reservation, Montana, a sovereign nation located within the United

¹⁴ See TandemMoney Terms and Fee Summary.

¹⁵ See TandemMoney Terms and Fee Summary.

¹⁶ TandemMoney Terms and Fee Summary.

¹⁷ See <http://insightcards.com/abouttandemmoney> (last visited 7/23/12).

States of America, and is operating within the Tribe's Reservation."¹⁸ Thus, it presumably makes loans throughout the country, ignoring state payday and usury laws.

The loans are a cross between an overdraft loan and an account advance. "SureCashXtra funds are loaned automatically as you use your prepaid card in times when you do not have enough money in your prepaid account to cover your purchase or ATM transaction."¹⁹

The loans are available only on prepaid cards that use a payment processor that has enabled the loans. The FAQs explain:

Each branded prepaid debit card has a transaction processor that evaluates and completes ATM and Point of Sale Signature transactions that are performed on their cards. The transaction processor for your prepaid card must allow SCX to be enabled on their system.²⁰

In addition to violating state law, the loans also seem to willfully ignore the Treasury rule banning direct deposits to prepaid cards that are linked to a loan agreement that triggers automatic repayment. As discussed in section 2 below, the application requires consumers to acknowledge the rule, but the website does not seem to disqualify borrowers if they receive federal benefits.

5. Overdraft Fees on Other Cards

In addition to the payday loan-type credit features described in the previous subsections, prepaid cards may carry regular overdraft fees. Fortunately, overdraft fees have generally been disappearing from prepaid cards. A 2009 survey by Consumer Reports found that most of the prepaid cards reviewed charged overdraft or shortage fees.²¹ Yet an updated survey in 2012 found that only three of the 16 cards reviewed had vague references to potential fees if the cardholder incurred a negative balance and it was not clear that any of those cards actually charged overdraft fees.²²

Some of the NetSpend cards have overdraft fees. A consumer who opts in can incur a negative balance up to \$100, including fees of \$15 each per overdrawn transaction. In practice, with fees triggered by separate small dollar transactions, this likely means \$55 in credit and \$45 in fees. The consumer is also required to opt in to text alerts and may avoid the fees by bringing the balance positive within 24 hours.

¹⁸ <https://mysurecash.com/Index.html> (last visited 7/23/12).

¹⁹ <https://mysurecash.com/LearnMore.html#two> (last visited 7/23/12).

²⁰ <https://mysurecash.com/FAQ.aspx> (last visited 7/23/12).

²¹ Michelle Jun, Consumers Union, "Prepaid Cards: Second-Tier Bank Account Substitutes" (August 2009), available at http://www.consumersunion.org/pub/core_financial_services/014300.html.

²² Consumer Report, "Prepaid Cards: Loaded with Fees, Weak on Protections" (March 2012), available at http://www.consumersunion.org/pdf/Prepaid_Cards_Report_2012.pdf.

Assuming a 10-day average term and a \$25 overdrawn purchase triggering a \$15 fee, the equivalent APR would be over 2,000%. The cards are available nationwide.

Though the NetSpend overdraft program does not permit fees to accumulate as high as some traditional bank overdraft program, it still has the result of putting consumers into a cycle of debt that perpetuates itself without truly giving the consumer any additional spending power.²³ After the first month, the consumer is merely borrowing to make up the \$100 shortfall in income, yet can only get \$55 in additional spending power. That is, the added \$45 fees each month are merely added to the monthly expenses, leaving the consumer short each month instead of in a better position to withstand emergencies or large expenses.

Other overdraft fee practices may be hidden from view and difficult to find merely by reviewing account agreements online. For example, NetSpend's top official has spoken publicly about its overdraft fees.²⁴ Yet those fees do not appear on NetSpend's website. Thus, overdraft fees may be more prevalent on prepaid cards than we realize.

6. Possible Big Bank Prepaid Card Payday Loans

Four large banks – U.S. Bank, Wells Fargo Bank, Fifth Third Bank and Regions Bank, are offering payday loans in the guise of “account advance” products. The loans cost \$7.50 to \$10 per \$100, depending on the bank, and are repaid in one lump sum automatically upon the next direct deposit.²⁵ For the average 10-day loan, the equivalent APR is 274% to 365%.

Three of these banks, Wells Fargo,²⁶ U.S. Bank²⁷ and Regions,²⁸ also offer prepaid cards.²⁹ Wells Fargo³⁰ and Regions³¹ appear to have a rule prohibiting any link between its payday loan

²³ NetSpend has acknowledged that most consumers borrow repeatedly.

²⁴ See Testimony of Mr. Daniel R. Henry, Chief Executive Officer, NetSpend Holdings, Inc., Hearing: Examining Issues in the Prepaid Card Market, Committee On Banking, Housing, And Urban Affairs Subcommittee On Financial Institutions And Consumer Protection at 3(Mar. 14, 2012), available at http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=2bf6b634-fbf6-40d8-a859-3af59300f9d0&Witness_ID=b5fbcae3-a234-4d44-b13a-4f990befafe7.

²⁵ See National Consumer Law Center, “300% Bank Payday Loans Spreading” (August 2011), available at http://www.nclc.org/images/pdf/banking_and_payment_systems/ib_bank_payday_spreading.pdf.

²⁶ Wells Fargo Prepaid Card: <https://www.visaprepaidprocessing.com/WellsFargo/PrePaidCard/Pages/Home.aspx> (last visited 7/23/12).

²⁷ U.S. Bank Convenient Cash Card: <http://www.usbank.com/prepaid/convenient-card.html> (last visited 7/23/12).

²⁸ Regions Now Banking: http://www.regions.com/personal_banking/now_banking.rf (last visited 7/23/12).

²⁹ Fifth Third's cards appear to be gift cards only, or debit cards issued in connection with a checking account. <https://www.53.com/site/personal-banking/credit-debit-cards/index.html> (last visited 7/23/12).

³⁰ “Is the Wells Fargo Prepaid Card connected to my credit? No. The Wells Fargo Prepaid Card is not tied to your personal credit in any way.” <https://www.wellsfargo.com/giftcard/reloadable-cards/prepaid-card/faq> (last visited 7/23/12).

³¹ The terms and conditions state: “You cannot link the Card to any deposit or credit account that you may have with us or with any other financial institution, except as provided in this Agreement.” The Agreement appears not to provide for any such linkage. <http://www.regions.com/virtualDocuments/Now-Banking-Terms.pdf> (last visited 7/23/12).

and its prepaid card. It is possible, however, that U.S. Bank permits prepaid card holders to access the credit line.

B. Keeping Overdraft Fees and Credit Off Prepaid Cards is Essential to Protect Consumers, Prevent Unfair, Deceptive and Abusive Practices, and Preserve the Integrity of Prepaid Cards

1. “Prepaid” Should Mean Prepaid

Prepaid cards should not have any overdraft or credit feature. The very term “prepaid” should mean what it says: paid in advance, the very antithesis of credit. Consumers’ understanding of what “prepaid” means comes from the common definition of that term and from the barrage of advertising that they see from the entire industry.

The cards are typically marketed with a variety of slogans that trumpet the absence of credit features:

- “It’s a Safer Way to Spend. No overspending, no overdraft fees. It’s prepaid, so you can only spend what’s preloaded on the Card. That means there’s no risk of overdraft fees or impacting your credit history.”³²
- “The better alternative to traditional banking. Many “free” checking accounts allow you to spend more than you have in your account and then charge you overdraft or NSF fees that can exceed \$30. With RushCard, you can only spend what is on your card so you’ll never be charged costly overdraft fees.”³³
- “It’s A Smarter Way To Manage Your Everyday Spending. The Approved Card is a prepaid card, not a credit card, so you can’t get into debt when you use it.”³⁴
- “The Better Way to Bank. AccountNow Prepaid Visa Card. No credit check | No overdraft fees.”³⁵
- “Advance America Visa® Prepaid Cards Go Everywhere. Without Going Over. Spend only what you load.”³⁶

Other terms used to describe prepaid cards, like “control,” also imply that spending cannot get out of control by extending beyond available funds or triggering advertent overdraft fees:

- “Take Control of Your Money with the Smart Banking Alternative.”³⁷

³²American Express:

https://www212.americanexpress.com/dsmlive/dsm/dom/us/en/personal/cardmember/additionalproductsandservices/giftcardsandtravelerscheques/gpr_howitworks.do?vgnextoid=d22b9484214ec210VgnVCM100000defaad94RCRD&vgnextchannel=95ddb81e8482a110VgnVCM100000defaad94RCRD&appInstanceName=default&name=gpr_howitworks&type=intbenefitdetail

³³RushCard: <http://www.rushcard.com/whyrushcard/default.aspx>.

³⁴The Suze Orman Approved Card: <http://theapprovedcard.com/index.php>.

³⁵AccountNow: <http://www.accountnow.com/>.

³⁶Advance America: <http://www.advanceamerica.net/services/details/visa-prepaid-cards>.

- “The Convenient Cash Card is a multi-purpose Visa® prepaid debit card that helps you take greater control of your financial life.”³⁸

The prepaid card industry arose to serve consumers who have trouble managing credit or who have been burned by overdraft fees and the delayed payment of checks. Even if a particular card is not marketed using these representations, the point that prepaid cards are safe has been drummed into consumers through these advertising campaigns. To allow the industry to load overdraft or credit features onto these cards, contrary to the name “prepaid” and to the deeply-embedded impressions created by these advertisements, would be a grave disservice to consumers.

Consumers are also subject to bait-and-switch tactics if overdraft and credit are not prohibited on prepaid cards. For example, one prepaid card uses this slogan to promote its card: “Because it's a prepaid card, you can only spend what you load onto the card.”³⁹ But the card offers opt in overdraft fees, making the slogan deceptive. Another prepaid card that has an opt-in overdraft fee program promotes its card in terms that would seem inconsistent with such fees:

“It puts you in control because it's powered by your cash. It is also often a cheaper alternative to costly credit cards and bank accounts. There are no finance charges, no credit card debt, no minimum balance, no credit bureau check and no surprises!”⁴⁰

The CFPB should preserve the common understanding of what prepaid cards are, and prevent confusion and deception, by banning overdraft fees and credit features on prepaid cards.

2. Prepaid Card Users Are Vulnerable Consumers

Prepaid card users are vulnerable consumers, making it especially important to keep prepaid cards a safe product without the dangers of overdraft fees or credit features. Prepaid card usage is not evenly distributed across the population. Those who use prepaid cards fall into several vulnerable groups, including:

- Lower income consumers;
- Unbanked or underbanked consumers with less access to or familiarity with the traditional banking system;
- Younger, less experienced or less educated consumers;

³⁷ NetSpend Control Prepaid MasterCard: “Take Control of Your Money with the Smart Banking Alternative.” https://www.mycontrolcard.com/prepaid-debit-card/applyNow.m?AID=C_GGL&SUB=prepaid%20visa&SITEID=Visa+Prepaid.

³⁸ U.S. Bank Convenient Cash Card: <http://www.usbank.com/prepaid/index.html> (last visited 7/23/12).

³⁹ <https://www.checksmartstores.com/services/ohio/> (last visited 7/22/12).

⁴⁰ <https://www.netspend.com/prepaid-debit-card/applyNow.m?AID=corporate&SITEID=corporate&r=> (click on “Learn more about the NetSpend Visa Prepaid Card”) (last visited 7/22/12).

- Consumers who have struggled with credit problems;
- Recent immigrants, who may be less familiar with the financial system;
- Consumers with fragile economic situations, including single parents, those who are recently unemployed, and families coping with the financial obligations of children;
- Public benefit recipients.

It is particularly important to provide protections for these groups to promote their well-being and prevent them from being subjected to unfair and disadvantageous practices.

Individuals who use prepaid cards tend to be low-income consumers. A recent Aite Group survey of consumers who use alternative financial services found that 44% of the prepaid card users surveyed earned less than \$30,000.⁴¹ In 2010, the National Council of La Raza (NCLR) conducted a survey of prepaid card users at Volunteer Income Tax Assistance (VITA) sites.⁴² Of the respondents, over 80% earned less than \$25,000 annually.⁴³

Cards that permit overdrawn transactions are dangerous to low-income consumers, who have been found to have a higher rate of recurrent overdrafts.⁴⁴ Those consumers often do not realize when they trigger an overdraft.⁴⁵

A study from 2005 identified ten clusters of unbanked households, three of which were particularly attracted to prepaid cards: young families, Latino immigrants, and the never-banked.⁴⁶ The young families cluster was made up of younger, lower-income families that tended to have at least a high school education.⁴⁷ Most were African-American with a median

⁴¹ Aite Group, *GPR Cardholders: Who Are They Really? Dispelling the Myths*, NETWORK BRANDED PREPAID CARD ASS'N 3 (Mar. 2012) (Aite Group Myths), <http://www.nbpc.org/~media/E6E6F720492F4E42804FED2A795D3B5A.ashx>.

⁴² NAT'L COUNCIL OF LA RAZA, PERSPECTIVES ON PREPAID CARDS FROM LOW-INCOME HISPANIC TAX FILERS 1 (2011) (NCLR Prepaid Survey), available at http://www.nclr.org/images/uploads/publications/perspectives_on_prepaid_cards_%283%29.pdf. The respondents were individuals who sought tax assistance at one of five Volunteer Income Tax Assistance (VITA) sites that NCLR targeted. *Id.*

⁴³ *Id.* Additionally, in a small Center for Financial Services Innovation study of prepaid card consumers, the median annual personal income for participants was well under \$25,000. CFSI Getting By or Ahead at 11.

⁴⁴ See NEAL WALTERS, AARP PUB. POLICY INST., PREPAID CARDS: PROMISE AND PITFALLS FOR CONSUMERS 3 (2010), available at http://assets.aarp.org/rgcenter/ppi/econ-sec/insight47_prepaid.pdf.

⁴⁵ See PEW HEALTH GRP., UNBANKED BY CHOICE: A LOOK AT HOW LOW-INCOME LOS ANGELES HOUSEHOLDS MANAGE THE MONEY THEY EARN 11 (2010), available at http://www.pewhealth.org/uploadedFiles/PHG/Supporting_Items/PEW%20Unbanked%20Report_FINAL.pdf. Of the 44% of banked low-income consumers in Los Angeles surveyed that had had an overdraft, 72% did not know they were out of money at the time of the overdraft. *Id.*

⁴⁶ E. Seidman, et al, Center for Financial Services Innovation, "Getting to Know Unbanked Consumers: A Financial Services Analysis" (Sept. 2005) (CFSI Unbanked Consumers), available at http://cfsinnovation.com/system/files/imported/managed_documents/seg.pdf.

⁴⁷ *Id.*

income of less than \$25,000, and many were interested in rebuilding credit.⁴⁸ The Latino immigrant cluster was made up of individuals most of whom were born in Mexico, and many of whom never had a bank account.⁴⁹ Fewer than half had a high school degree, many were young and had children. Members of this cluster were more likely to be paid in cash.⁵⁰ The never-banked cluster was a mainly African-American group with an average income of less than \$10,000.⁵¹

Prepaid card usage is more prevalent among the unbanked and underbanked.⁵² In a 2009 FDIC study of unbanked and underbanked households, 12% of unbanked households and 16% of underbanked households reported that they had used a general spending prepaid card, compared to 9.7% of all households surveyed.⁵³ Nearly 30% of prepaid card users in the survey conducted by NCLR at VITA sites were unbanked.⁵⁴

Since racial and ethnic minority households are more likely to be unbanked or underbanked, predatory lending that is targeted toward the unbanked or underbanked raises fair lending concerns. As the FDIC study found, 21.7% of black households and 19.3% of Hispanic households were unbanked, compared to 3.3% of white households.⁵⁵ Not only are some minority households more likely to be unbanked, but they also make up a disproportionately high percentage of all unbanked households relative to their population. Out of all unbanked households, black households represented 36.9%, white households represented 30.5%, and

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² The FDIC has defined “unbanked” households as those without any kind of bank account and “underbanked” households as banked households that have used at least one of the alternative financial services (non-bank money orders and cash-checking services, payday loans, RTO agreements, and pawn shop loans) at least once or twice in the past year or have used a refund anticipation loan in the past 5 years. FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 15 (2009), *available at* http://www.fdic.gov/householdsurvey/Full_Report.pdf.

⁵³ *Id.* at 40 fig.5.9. A more recent study conducted by a market researcher earlier this year found that 18% of underbanked consumers owned prepaid cards, as opposed to 10% of all consumers. Press Release, Javelin Strategy & Research, Prepaid Cards Lure Underbanked and Gen Y Consumers (Apr. 11, 2012), *available at* <https://www.javelinstrategy.com/news/1326/92/1>. The report also indicates that 18% of young consumers own prepaid cards.

⁵⁴ NCLR Prepaid Card Survey at 1.

⁵⁵ FDIC NATIONAL SURVEY at 17 fig.4.2. American Indian/Alaskan and Hawaiian/Pacific Islander households were also more likely to be unbanked than the general population, with 15.6% and 9.2% of households unbanked, respectively. *Id.* Asian households were less likely to be unbanked than the 7.7% national estimate, as 3.5% of Asian households were unbanked. *Id.* The distribution of underbanked households across racial and ethnic groups followed a similar pattern. 31.6% of black households, 28.9% of American Indian/Alaskan households, and 24% of Hispanic households were underbanked, all of which exceeded the national estimate of 17.9% of households. *Id.* at 32 fig. 5.1. This compared to 16.4% of Hawaiian/Pacific Islander households, 14.9% of white households and 7.2% of Asian households. *Id.*

Hispanic households represented 28.1%.⁵⁶ By comparison, the overall distribution of U.S. households is 70.4% white, 13.1% black, and 11.1% Hispanic.⁵⁷

The FDIC study also determined that households with certain characteristics were more likely to be unbanked. Households with a householder who earned less than \$30,000 per year, who held less than a high school degree, who was a foreign-born noncitizen, or who was under the age of 45 were all more likely to be unbanked.⁵⁸

Prepaid card users have other characteristics that increase their vulnerability as consumers. The NCLR survey at VITA sites indicated that about 65% of the prepaid card users were recently unemployed, 75% had children, and almost 80% were single.⁵⁹ Employment instability and child care can strain a household budget, especially for a low-income household with a single wage earner.

Prepaid card users tend to be less educated than other consumers. The Aite survey found that 30% of respondents who used prepaid cards had only a high school education or less.⁶⁰ Other studies have also found high prepaid card use among consumers with less education.⁶¹ Not only does this lack of higher education affect earning capacity, but it also may impact the ability of consumers to understand the terms and policies of financial products such as prepaid cards.

Many prepaid card users are public benefit recipients. In addition to cards offered directly by government agencies, prepaid card issuers promote the ability to receive direct deposit of public benefits:⁶²

⁵⁶ *Id.* at 18 fig. 4.5. Additionally, American Indian/Alaskan households represented 2.4% of unbanked households, Asian households made up 1.8%, and Hawaiian/Pacific Islander households made up 0.4%. *Id.* Of all underbanked households, white households represented 58.4%, black households represented 23.0%, Hispanic households represented 14.9%, American Indian/Alaskan households represented 1.8%, Asian households made up 1.6%, and Hawaiian/Pacific Islander households made up 0.2%. *Id.* at 33, fig. 5.2.

⁵⁷ *Id.* at 18 fig. 4.5. Asian households made up 4.0% of all U.S. households, American Indian/Alaskan households represented 1.1%, and Hawaiian/Pacific Islander households made up 0.2%. *Id.*

⁵⁸ FDIC NATIONAL SURVEY at 16. Other characteristics identified were households with a black, Hispanic, or American Indian householder, households where Spanish was the only language spoken at home, and family households with an unmarried female or male householder. Households with the following similar, but not identical, characteristics were more likely to be underbanked: those with a black, Hispanic, or American Indian householder; family households with an unmarried female or male householder; those earning up to \$50,000; those with a householder holding less than a college degree; or those with a householder under age 55. *Id.* at 32.

⁵⁹ NCLR Prepaid Survey at 1. Other key findings were that 35% of respondents were Hispanic, nearly 30% were unbanked, and over 10% were Spanish speakers.

⁶⁰ Aite Group Myths at 3.

⁶¹ *See, e.g.*, FDIC NATIONAL SURVEY at 16 (unbanked consumers have less education); CFSI Unbanked Consumers at 3 (less than half had any college education and many clusters were even less educated).

⁶² *See, e.g.*, NetSpend Prepaid Card, <https://www.netspend.com/> (last visited July 13, 2012) (“Get Paid Up To 2 Days Faster! Direct Deposit to your prepaid card is the easy way for payroll checks and government payments to be automatically delivered to your NetSpend Prepaid account.”); H&R Block Emerald Prepaid Mastercard, <http://www.hrblock.com/bank/products-services/emerald-prepaid-mastercard.html> (last visited July 13, 2012) (“Avoid check cashing fees with Direct Deposit of your payroll, unemployment or government benefits (Social security, Medicare, Disability, Welfare, Military, etc) and have immediate access to your money on payday.”); Why

- “The NetSpend BenefitsExpress feature makes it easy to set up Direct Deposit of government benefits like Social Security, SSI, SSDI or VA compensation.”⁶³
- “There’s no charge for doing direct deposit, so you’ll never have to pay to cash your payroll or benefits check when you use our direct deposit service.”⁶⁴
- “Have pay, dividends, disability and government checks (i.e., Social Security, Medicare, Welfare, etc.) sent directly to your Wired Plastic Card account, FREE. Your funds are available the same business day they are received.”⁶⁵

Prepaid cards are also often used for teens, and some cards are specifically geared toward teens. They advertise prepaid cards to parents as a tool to teach their children about finances⁶⁶ and to teens as fun products, often using colorful graphics⁶⁷ and entertainment references.⁶⁸ Young adults can be particularly susceptible to incurring fees while using a prepaid card, since they are less likely to understand the fee schedules associated with the card and to have the experience to use the card in a way to avoid fees.

Overall, prepaid card users are characterized by numerous factors that make them a vulnerable population that needs a safe transaction account that does not put them at risk of incurring debt, unwanted fees, or financial strain.

This Card: Card Benefits, Univision MasterCard Prepaid Card, <http://www.univisiontarjeta.com/en/prepaid-mastercard-benefits/> (last visited July 13, 2012) (“Direct deposit automatically adds your money from your paycheck, government benefits or tax refund directly to your card. No more waiting for the check or rushing to the bank to cash it. The money will be added to you card even if you cannot pick it up, or are out sick or on vacation. It’s FREE to sign-up and use!”).

⁶³ NetSpend Prepaid Card, https://www.netspend.com/how_it_works/adding_money/direct_deposit.shtml (last visited July 13, 2012).

⁶⁴ AccountNow, <http://www.accountnow.com/> (last visited July 13, 2012).

⁶⁵ Top 10 Reasons to Choose Wired Plastic, Wired Plastic Visa Prepaid Card, <http://www.wiredplastic.com/top10.php> (last visited July 13, 2012).

⁶⁶ See, e.g., Teach Your Teens Financial Responsibility, The Approved Card, <http://theapprovedcard.com/whychoosetac/teachyourteens/> (last visited July 13, 2012) (“You can set up 3 additional Approved Card accounts for your teens aged 13 and older so they can learn how to manage money.”); PAYjr Visa Buxx Card, <http://www.payjr.com/teenprepaidcard.html> (last visited July 13, 2012) (“This prepaid card gives teens flexibility and spending independence, in addition to teaching them personal financial management.”).

⁶⁷ See, e.g., Pass from American Express, https://www.americanexpress.com/us/content/prepaid/pass.html?vgnextchannel=95ddb81e8482a110VgnVCM100000defaad94RCRD&appInstanceName=default&vgnextnoice=1&name=pass_markup_homepage&type=intbenefitdetail (last visited July 13, 2012); MYPLASH Teen Prepaid MasterCard, <http://myplash.com/> (last visited July 13, 2012).

⁶⁸ See, e.g., What’s MYPLASH?, MYPLASH Teen Prepaid MasterCard, http://myplash.com/whats_myplash (last visited July 13, 2012) (“At MYPLASH we want to make sure you’re always carrying the coolest prepaid card around. That’s why we’re constantly on the lookout for awesome brands, music artists, celebrities, and athletes to put in your pocket.”).

3. Prepaid Card Users Want Controls on Overspending

The prepaid nature of prepaid cards, with funds that cannot be overspent and do not trigger overdraft fees, is important to prepaid card users. Prepaid cards may be a checking account replacement for consumers who have been excluded from bank accounts or have had trouble managing overdrafts. Other consumers may have bank accounts but supplement them with prepaid cards as a budgeting tool.

A Pew study found that “[t]he vast majority of participants reject the idea of including overdraft options on prepaid cards. Many envision getting into the same spiral of trouble with overdraft fees on their prepaid cards that they have had with their checking accounts.”⁶⁹ One participant told interviewers, “Nobody wants to pay extra fees. If [I] had to, I’d take the \$3.95 [to reload a prepaid card] any day over the \$35 overdrafting or for some other fees.”⁷⁰ Another Pew study respondent commented, “You’re not overdrafting, and what’s on there is what’s actually on there. If you have a prepaid card with \$500, it’s a \$500 limit. There’s \$500 on it.”⁷¹

The Pew study also concluded that participants were “uneasy” about including credit features on prepaid cards: “While some say credit could be useful in an emergency, most express concern that it would undermine the perceived value of having a prepaid card—to budget and avoid overspending.”⁷²

In a Center for Financial Services Innovation (CFSI) study, some prepaid card users exhibited this uneasiness by choosing to turn off a related bill payment feature, or not sign up for it at all. They were uncomfortable with the uncertainty of having a bill post when they did not have enough funds on their cards to cover it.⁷³

A different CFSI study on consumers’ views of prepaid cards produced similar results. The survey found that 80% of respondents reported that the ability of prepaid cards to allow them to avoid the overdraft fees of checking accounts was either a very or extremely significant benefit.⁷⁴

⁶⁹ PEW HEALTH GRP., KEY FOCUS GROUP FINDINGS ON PREPAID DEBIT CARDS 3 (2012), *available at* http://www.pewhealth.org/uploadedFiles/PHG/Content_Level_Pages/Issue_Briefs/FSP_12014%20Pew%20DebitCards_R10A-4-5-12.pdf.

⁷⁰ *Id.* at 1.

⁷¹ *Id.* at 2.

⁷² *Id.* at 3.

⁷³ CFSI Getting By or Ahead at 22.

⁷⁴ Ctr. for Fin. Servs. Innovation, *Underbanked Reloadable Prepaid Card Users: A Public Opinion Survey*, NETWORK BRANDED PREPAID CARD ASS’N 6 (Mar. 9, 2009) (CFSI 2009 Opinion Survey), <http://www.nbpca.org/~media/D005ADD48C31459EB150F143AFACC25C.ashx>. A participant in the other CFSI survey emphasized this benefit, telling interviewers, “If the money is not there, can’t nobody take it out. You know they don’t pay it so I don’t incur no fees.” CFSI Getting By or Ahead at 20. Another respondent approvingly stated, “The good thing about [prepaid cards] though is that you can’t write checks and have them bounced. It’s like the funds are either there [or not]; the transaction either passes or doesn’t. So it’s a good discipline for me.” *Id.* (second alteration in the original).

Consumers have also adopted prepaid cards as a tool for budgeting, specifically due to the lack of overdraft or credit features on prepaid cards. About 55% of individuals (including 63% of Hispanics) in the NCLR survey indicated that what they liked most about their prepaid cards was that they “could only spend the amount of money [they] had.”⁷⁵ Similarly, a Pew focus group study participant opined, “I know that whatever is on [the prepaid card] is the only thing that I can spend. I’m not using my real credit card where I can spend and pay a little bit a month. I know I’m only allowed to use what is on that card, and that actually limits me as well.”⁷⁶ The CFSI studies also found that prepaid card users believed that the “built-in discipline” that prepaid cards provided to users was an advantage.⁷⁷ Of the respondents in the consumer opinion survey, 41% indicated that they used their reloadable prepaid card to keep their spending within a budget,⁷⁸ and 76% said that it was either a very or extremely significant benefit of prepaid cards that they allowed users to manage their budget and not overspend.⁷⁹

Overdraft fees and trouble managing checking accounts is frequently what drives consumers out of bank accounts and into prepaid cards. Indeed, 6.9% of households who previously had bank accounts in the FDIC study closed their accounts because they could not manage or balance the account and 8.3% of households closed their accounts because they bounced too many checks or had too many overdrafts.⁸⁰

In a study by the National Urban League, 57% of respondents and 66% of unbanked respondents indicated that prevalence of fees, including overdraft fees, presented a major barrier to having a checking account.⁸¹

The Federal Reserve Bank of Kansas City conducted a study of the unbanked and underbanked in the Tenth Federal Reserve District and found that those individuals often had negative experiences with banks in the past, including negative experiences related to overdraft fees.⁸² One participant asserted, “What banks should do is be more honest and reject my check when I don’t have enough money, but they don’t do this because they want to charge you the overdraft fee, which is very high.”⁸³

⁷⁵ NCLR Prepaid Survey at 3.

⁷⁶ PEW HEALTH GRP at 2.

⁷⁷ See CFSI Getting By or Ahead at 20; CFSI 2009 Opinion Survey at 6-7.

⁷⁸ CFSI 2009 Opinion Survey at 5.

⁷⁹ *Id.* at 7.

⁸⁰ FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 27 fig.4.14 (2009), available at http://www.fdic.gov/householdsurvey/Full_Report.pdf. Comparatively, 3.8% of never-banked households indicated that they did not have an account because they could not manage or balance the account and 1.7% said they bounced too many checks or had too many overdrafts. *Id.*

⁸¹ NAT’L URBAN LEAGUE POLICY INST., NULPI FACT SHEET: MINORITIES AND BANKING ACCESS 2 (2008), available at <http://www.nul.org/sites/default/files/MinorityBankingAccess.pdf>.

⁸² See FED. RESERVE BANK OF KANSAS CITY, A STUDY OF THE UNBANKED & UNDERBANKED CONSUMER IN THE TENTH FEDERAL RESERVE DISTRICT 6 (2010), available at <http://www.kansascityfed.org/publicat/research/community/Unbanked.Report.pdf>.

⁸³ *Id.*

On the whole, consumers do not want overdrafts or credit features on prepaid cards. Some consumers specifically switch to prepaid cards to avoid these aspects of bank accounts or credit cards. They are looking for the control of not being able to spend more than they have. Permitting bait and switch tactics that expose these consumers to dangerous credit features eliminate that control.

4. Offering Overdraft Coverage on a Product that Does Not Overdraft, and Without Even Promising Transaction Approval, is Deceptive and a Means of Evading Credit Laws

Overdraft coverage on prepaid cards is deceptive on two counts. First, “overdraft” is a misnomer on prepaid cards because the cards are designed, by their very nature, to prevent overdrafts.⁸⁴ Second, the credit impliedly promised by overdraft programs may not even be there when desired.

The original, ostensible purpose of overdraft coverage is to protect consumers when they make a “draft” that is presented at a later time when, inadvertently, there are insufficient funds to cover that draft. This rationale applies to payments by checks but not to ATM and debit/prepaid card transactions that are approved or denied contemporaneously, with no risk of inadvertent overdrafts or bounced check fees. Prepaid cards are designed not to overdraft. Overdraft programs on prepaid cards are not designed to cover overdrafts at all; they merely vehicles for credit pure and simple. Whether consumers want credit is a separate question, but it is credit, not overdraft coverage, that they are being offered.

Overdraft programs on prepaid cards are inconsistent with the rationale that regulators used decades ago to exempt bank account overdraft coverage from the Truth in Lending Act. The Federal Reserve Board (FRB) reasoned that automated overdraft programs were comparable to the manual discretionary process that bankers had long used to decide whether to honor an occasional check despite a lack of funds. The Board also pointed out that overdraft fees were typically comparable to the nonsufficient fund fees (NSF) that the consumer would pay even if the account were not permitted to be overdrawn. Consequently, the FRB determined that the fees charged through “courtesy” overdraft programs, whether automated or not, were not finance charges and did not require compliance with Regulation Z unless the bank promised in writing to pay an item or the fee exceeded the NSF fee that would be charged if overdraft credit were not extended.⁸⁵

⁸⁴ Though there is a small category of overdrawn transactions that cannot be prevented, by definition those transactions have been approved. Thus, there is no benefit to the consumer to authorizing a fee for those overdrafts and any solicitation for overdraft coverage in this situation would be unfair and deceptive.

⁸⁵ See 69 Fed. Reg. 31760 (June 7, 2004); 70 Fed. Reg. 29,582 (May 24, 2005); Regulation Z, 15 U.S.C. § 226.4(b)(2)

But prepaid cards do not have checks, so there is nothing to “honor” that would be comparable to a manual, discretionary, ad hoc process. Prepaid card programs are purely automated and overdrawn transactions are simply denied. Overdraft programs on prepaid cards are a vehicle for extending credit, not for covering checks. Because they do not have checks that can bounce, prepaid cards also do not have NSF fees that are comparable on accounts without credit features.⁸⁶

Prepaid card overdraft programs currently rely on convoluted regulatory treatment developed in the bank account context, which requires deception on the part of bankers. On the one hand, under Regulation E, they must obtain the consumer’s consent to opt in to overdraft coverage, using come-ons that imply that the consumer is protected and should opt in in case coverage is needed. But to avoid Regulation Z, bankers cannot tell consumers how much credit they actually have and they need to say in the fine print that they are not actually promising to pay overdrafts.

The messages sent to consumers to encourage them to opt in to overdraft programs are inherently deceptive because they imply a promise that is never made. Overdraft programs encourage consumers to opt in by promoting the advantages of having credit available:

- “For life’s surprises, your Insight Visa® Prepaid Card offers opt-in overdraft protection. Mistakes can happen, but with overdraft protection, you can help ensure you are covered when you need to be*.”⁸⁷

But the fine print tells consumers that there is no guarantee that the credit will be there when they need it.

- “Whether your overdrafts will be paid is discretionary and we reserve the right not to pay.”⁸⁸

These shenanigans are bad enough in the bank account setting. As we have explained elsewhere, overdraft fees should never be triggered by ATM or debit card transactions.⁸⁹ But this farce has absolutely no place on prepaid cards, which lack unfunded checks.⁹⁰ The regulatory authority to exempt these products from credit laws is completely absent, and offering “overdraft” coverage on a product designed without overdraft capacity is unfair, deceptive and abusive. There is

⁸⁶ Some prepaid cards charge denied transaction fees, but they are usually pennies, far below the amount of overdraft fees. The FRB has also questioned whether such fees violate rules against unfair or deceptive practices. *See* 74 Fed. Reg. 59033, 59041 (Nov. 17, 2009).

⁸⁷ CheckSmart’s Insight Visa Prepaid Card: <https://www.checksmartstores.com/services/arizona/> (last visited July 16, 2012).

⁸⁸ *Id.*

⁸⁹ *See* Center for Responsible Lending et al, Comments to the Consumer Financial Protection Bureau Docket No. CFPB-2012-0007, Impacts of Overdraft Programs on Consumers (June 29, 2012) (Overdraft Comments to CFPB), available at http://www.nclc.org/images/pdf/rulemaking/overdraft_comment_by_crl_cfa_and_nclc.pdf.

⁹⁰ Some prepaid cards have check features, but funds are withdrawn and set aside at the time that the consumer initiates the payment. This is what makes these cards available to those who have negative records with ChexSystems.

absolutely no basis for tolerating the deception or regulating a credit product under laws designed for deposit products.

5. Congress Endorsed the Policy of Banning Overdraft Fees on Prepaid Cards

Congress exempted prepaid cards from the interchange fee caps of the Dodd-Frank Act. But the exemption came with a condition: no overdraft fees. The conditional exemption served a twofold purpose: ensuring that interchange fees would continue to be available to subsidize prepaid card accounts for low balance consumers while protecting those account from the inappropriate use of overdraft fees as a revenue driver on prepaid cards.

The interchange fee cap only covers banks and credit unions that have over \$10 billion in assets. Cards issued by smaller institutions do not need to comply with the overdraft fee ban even if they charge high interchange fees. But Congress did not bless such overdraft fees; it merely chose not to regulate the interchange fees charged by smaller institutions, and thus did not have the occasion to address their prepaid cards.

An even-handed rule prohibiting overdraft fees on all prepaid cards will implement Congress' clear preference that overdraft fees be banned on prepaid cards. It will level the playing field and prevent prepaid card companies from using smaller banks to evade the congressional policy against overdraft fees on prepaid cards.

Prepaid card consumers need protection from overdraft fees regardless of the size of the card issuer. Consumers are unlikely to even know whether the card is issued by a small or large bank (or a nonbank). Merchants can tolerate higher interchange fees on smaller issuer cards because they are balanced out by relief from high fees on the vast majority cards. But for consumers, it is all or nothing; their card has only one issuer. The established public policy of banning overdraft fees on prepaid cards issued by large banks supports banning them on all cards.⁹¹

Moreover, as discussed in greater detail in section III.A.3 below, if the CFPB enacts a general rule that prepaid cards may not have overdraft fees or credit features, the Federal Reserve Board could use that rule to improve the unfortunate limitations imposed on large bank prepaid cards through the interchange fee regulations.

⁹¹ That policy is also reflected in the Treasury rule prohibiting credit features on prepaid cards that accept direct deposit of federal payments. If the CFPB uses its authority over unfair practices to address overdraft fees, it may consider public policy. 12 U.S.C. § 5531(c)(2).

6. Prepaid Cards Promote the Lack of a Credit Check and Do Not Underwrite for Ability to Pay

Prepaid card are frequently marketed as “no credit check”⁹² or “100% approval”.⁹³

- “100% approval* ensures you will qualify for an AccountNow Visa Prepaid Card or Prepaid MasterCard Card as long as you have valid identification. If you have bad credit history or no credit at all you can still get an AccountNow Prepaid Card because we don't do a credit check with a credit bureau. Even if your banking history isn't great or you are on ChexSystems, you are still eligible to get one of our prepaid cards.”⁹⁴
- “Guaranteed Approval once ID is verified* – No credit check or bank verification. Even a bankruptcy! We do not care. It's your money. The only requirement for a Bank Freedom Prepaid MasterCard is valid identification. That's it.”⁹⁵

The lack of a credit check is an appealing marketing hook only for those with blemished credit. One of the main benefits of prepaid cards is that they are available to those who are listed in ChexSystems or otherwise have checkered bank account or credit histories.

Providing credit on a product that lacks underwriting is inappropriate. Credit cards, and all forms of responsible lending, require an assessment of ability to pay.⁹⁶ Yet little or no such assessment is done on prepaid cards that have overdraft fees or other credit features.⁹⁷

⁹² E.g., NetSpend Prepaid Card, <https://www.netspend.com/> (last visited July 13, 2012); Western Union MoneyWise Visa Prepaid Card, <https://www.mycardplace.com/cards/onlineSalesWU.do> (last visited July 13, 2012); Reloadable Prepaid Cards, nFinanSe, <https://www.nfinanse.com/reloadable> (last visited July 13, 2012); Walmart MoneyCard, <https://www.walmartmoneycard.com/walmart/> (last visited July 13, 2012); Green Dot, <https://www.greendot.com/greendot/getacardnow> (last visited July 13, 2012); AccountNow, <http://www.accountnow.com/> (last visited July 13, 2012); What Is the American Express Prepaid Card?, American Express Prepaid Card, https://www.americanexpress.com/us/content/prepaid/american-express-prepaid-card/how-it-works.html?vgnextchannel=95ddb81e8482a110VgnVCM100000defaad94RCRD&appInstanceName=default&name=gpr_howitworks&type=intbenefitdetail (last visited July 13, 2012); Upside Visa Prepaid Card, <http://www.upsidecard.com/> (last visited July 13, 2012); Western Union MoneyWise Visa Prepaid Card, <https://www.mycardplace.com/cards/onlineSalesWU.do> (last visited July 13, 2012); Reloadable Prepaid Cards, nFinanSe, <https://www.nfinanse.com/reloadable> (last visited July 13, 2012); Bank Freedom Prepaid MasterCard, <http://www.bankfreedom.com/> (last visited July 13, 2012); Wired Plastic Visa Prepaid Card, <http://www.wiredplastic.com/> (last visited July 13, 2012).

⁹³ <https://www.walmartmoneycard.com/walmart/about-our-products>; <http://www.accountnow.com/>; <http://www.cashamerica.com/financialservices/PrepaidVisa.aspx>.

⁹⁴ AccountNow, <http://www.accountnow.com/> (last visited July 13, 2012).

⁹⁵ Bank Freedom Prepaid MasterCard, <http://www.bankfreedom.com/> (last visited July 13, 2012).

⁹⁶ As discussed below, prepaid cards with credit features should be considered to be credit cards under Regulation Z.

⁹⁷ For a longer discussion of why and how ability to pay should be considered in connection with overdraft and account advance programs, see Overdraft Comments to CFPB; Center for Responsible Lending et al., Comments to the Office of the Comptroller of the Currency, Docket ID OCC-2011-0012, Proposed Guidance On Deposit-Related Consumer Credit Products (Aug. 8, 2011) (Deposit-Related Credit Comments to OCC), available at http://www.ncl.org/images/pdf/high_cost_small_loans/payday_loans/occ-comments-payday-overdraft.pdf.

Issuers may make overdraft or credit features available only to those who have direct deposit or a history of deposits on the card. But that indicates only ability to collect, not ability to pay. The FTC’s Credit Practices Rule found long ago that it was an unfair and deceptive practice to lend based on the ability to seize the consumer’s wages or public benefits.⁹⁸ Other federal regulators have identified collateral-based lending as unfair and deceptive.⁹⁹ *The ability to seize collateral in the form of an incoming deposit to repay credit is a feature of predatory lending, not responsible underwriting.* Credit in any form (including overdraft) should not be permitted on a product that, by its nature, lacks underwriting in the form of an ability to pay analysis.¹⁰⁰

7. Prepaid Card Credit Features are Promoted for Large or Unexpected Expenses but Designed to Be Used Routinely, Encouraging a Cycle of Debt

Prepaid card companies that offer overdraft and credit features justify those features as providing a useful service to consumers who have an emergency or unexpected need for credit. But prepaid card credit features encourage everyday use.

Overdraft “coverage” is designed to make using credit automatic and constant. Consumers do not know that they are dipping into an overdraft at the time the card is used for a purchase. A cash withdrawal or purchase is approved with no advance warning that the account is overdrawn or a fee will be charged, even if the consumer would prefer that the transaction be denied.¹⁰¹ Though some prepaid cards offer a 24 hour grace period to bring the account positive before charging a fee, it is too late to undo the charge. Low balance alerts and other features can help remind consumers about their balances, but for a consumer struggling with insufficient income, it remains dangerously easy to use the coverage for ordinary expenses at the swipe of a card.

Other types of prepaid card credit require the consumer to affirmatively transfer the borrowed funds onto the card before they can be spent, but the structure of the credit still encourages routine use. The single balloon payment, automated nature of these repayments leaves the consumer in a hole the next month. The consumer then must borrow again merely to fill that hole. Studies on payday loans, overdraft programs, and bank account advance products prove over and over again how the products result in repeat usage.

⁹⁸ See 49 Fed. Reg. 7740 (Mar. 1, 1984), codified at 16 C.F.R. Part 444.

⁹⁹ See, e.g., Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, OCC Advisory Letter AL 2003-2 (Feb. 21, 2003); NCUA et al, Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569 (Jul. 10, 2007).

¹⁰⁰ To the extent that any form of credit is permitted on prepaid cards, it should be subject to the Regulation Z credit card rules, including the ability to pay requirement and the ban on fees exceeding 25% of the credit line in the first year. This issue is discussed in greater length in Overdraft Comments to CFPB at 33-34.

¹⁰¹ Surveys have shown that most consumers would prefer that debit card transactions be denied rather than approved with an overdraft fee. Center for Responsible Lending, “Consumers Want Informed Choice on Overdraft Fees and Banking Options” (April 16, 2008); see also Center for Responsible Lending, “Banks Collect Overdraft Opt-Ins Through Misleading Marketing” (Apr. 26, 2011) (60% of consumers who opted in to overdraft coverage stated that an important reason they did so was to avoid a fee if their debit card was declined.)

Prepaid cards, like bank payday loans, are likely to have much worse usage patterns than traditional payday loans because of their ease of use. They do not require visiting a payday lender and waiting in line for a loan. Indeed, the ease of account advance products may be one reason why the typical account advance user borrows 16 times a year,¹⁰² whereas the average payday borrower does so only eight or nine times. Similarly, another new easy-to-use product tied to employee' wage payments – Flex Wage -- found that consumers borrowed much more frequently than expected, on average 10 to 12 times a year.¹⁰³

Indeed, the credit offered by overdraft fees and short term, single payment products is illusory. Research has shown that 76 percent of payday loan demand is generated by previous loans,¹⁰⁴ and the pattern with prepaid card credit is likely to be as bad or worse. Consumers are merely borrowing from Peter to pay Paul, not gaining adding spending power to weather emergencies. The fees are so steep in relation to the amount of credit extended that consumers lose funds out of the next deposit that are needed to meet family needs. Overdrafts and loans repaid unilaterally out of the next deposit of pay or benefits function as wage assignments that the FTC long ago classed as unfair.¹⁰⁵

Credit that is truly designed for emergencies or occasional use must be structured consistent with that purpose. The loan must be an installment loan with small enough payments, over a long enough period, that the unexpected large expense can be spread out in a manner that is manageable. Almost by definition, if credit is needed to handle a large or unexpected expense, it cannot be repaid through a single paycheck. A loan with a several month repayment period cannot be used every month, but only on occasion, a couple of times a year, after the prior loan is repaid.

Theoretically, credit on prepaid cards could be designed with a more affordable structure, with installment payments over a period of time. But that form of credit is effectively a separate credit product and triggers credit laws. The entire purpose of overdraft fee and embedded credit features is to use offset and other devices to get at the deposits as a way of ensuring collections without complying with the laws regulating credit. The inherent nature of prepaid card credit features is dangerous short term, balloon payment loans that lead to repeat use and a cycle of debt and evade the legal protections for credit.

¹⁰² Center for Responsible Lending, “Big Bank Payday Loans: High-interest loans through checking accounts keep customers in long-term debt” (July 21, 2011), available at <http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.html>.

¹⁰³ Victoria Finkle, “With Payday Loans under Scrutiny, Startup FlexWage Offers Alternatives,” American Banker (June 1, 2012), available at http://www.americanbanker.com/issues/177_106/FlexWage-payday-loans-overdraft-payroll-cards-prepaid-1049818-1.html?zkPrintable=1&nopagination=1.

¹⁰⁴ Leslie Parrish and Uriah King, “Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume,” Center for Responsible Lending, July 9, 2009.

¹⁰⁵ Federal Trade Comm’n, Credit Practices Rule, 49 Fed. Reg. 7740 (Mar. 1, 1984), codified at 16 C.F.R. Part 444.

8. Banning Overdraft Fees and Credit Features Will Minimize Account Closures and Protect Access to Transaction Accounts

Many consumers turn to prepaid cards because they have had trouble managing overdrafts and are ineligible for checking accounts. Overdraft fee programs can lead to bank account closures.¹⁰⁶ Payday loans – a form of credit similar to the credit features on some prepaid cards – are also documented to lead to bank account closures.¹⁰⁷ Keeping prepaid cards as a safe alternative form of transaction account is critical for these consumers.

The FDIC recently concluded a pilot project on safe transaction accounts. The accounts were essentially prepaid cards: accounts without checks or the ability to overdraft. The accounts had no credit features. The accounts were marketed to unbanked consumers and were available to those with negative ChexSystems records.

The FDIC concluded that these accounts were viable despite the wide-open eligibility criteria, and that account closures were few. Indeed, the accounts might even have performed better than traditional accounts. The report concluded that the “relatively low overdraft risk, in combination with the higher retention rates, suggests that Safe Accounts may have greater longevity and lower costs than other deposit accounts.”¹⁰⁸

Protecting access to financial services is part of the CFPB’s mission. Consumers who can handle accounts that have checks that can result in overdrafts, or with credit features such as overdraft lines of credit, have access to traditional bank accounts. But for those who cannot, prepaid cards are about the only form of transaction account open to them. Keeping these accounts safe and available for these consumers is essential.

¹⁰⁶ A survey in the Detroit area found that among those surveyed who formerly had a bank account, 70 percent chose to close the account themselves, citing moving, worrying about bouncing checks, and excessive fees as their reasons for closing the account. The remaining formerly banked, 30 percent, reported that their bank closed their account; the primary reason was bounced checks and overdrafts. See Michael S. Barr, *Financial Services, Savings and Borrowing Among Low- and Moderate-Income Households: Evidence from the Detroit Area Household Financial Services Survey 12*, (Mar. 30, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1121195##. See also Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures 6*, (June 6, 2008), available at http://www.bostonfed.org/economic/cprc/conferences/2008/payment-choice/papers/campbell_jerez_tufano.pdf (noting that virtually all involuntary bank account closures, when the financial institution closes a consumer’s account, occur because the customer overdrew the account an excessive number of times).

¹⁰⁷ One study found that an increase in the number of payday loan outlets in a county is associated with an 11% increase in involuntary bank account closures, even when other variables such as income and poverty rate are taken into account. See Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures* (June 6, 2008) (paper presented at Boston Federal Reserve Board workshop on Consumer Behavior and Payment Choice).

¹⁰⁸ FDIC, “FDIC Model Safe Accounts Pilot, Final Report” at 7 (April 2012).

9. Permitting Overdraft and Credit Features on Prepaid Cards Will Create a Race to the Bottom and Undermine Honest Up-Front Pricing and Good Industry Actors

One of the central missions of the CFPB is to promote the ability of consumers to shop based on transparent, up-front pricing and to remove incentives that reward back-end tricks and traps. Banning overdraft fees and other credit features on prepaid cards will protect honest industry players that avoid dangerous tricks and will prevent less scrupulous providers from using back-end fees to make a product look more affordable than it is.

In the bank account world, a race to the bottom led institutions far and wide to promote “free checking” while engaging in worse and worse practices to induce consumers into incurring overdraft fees. Banks became completely dependent on overdraft income to cover the costs of maintaining accounts. Banks that charged clear and transparent monthly fees and did not engage in overdraft manipulations were at a disadvantage when competing against “free checking.”

Similarly, in the credit card market, banks put more and more of their profit margin in back-end fees and retroactive rate increases. Consumers who shopped based on advertised APRs were completely misled. Companies that advertised an honest APR and did not engage in back end manipulations could not compete.

The CFPB must not permit such deceptive practices on prepaid cards. Back end overdraft fees and credit features, which are very profitable, will lead to a race to the bottom.¹⁰⁹ A prepaid card issuer that has a revenue stream from overdraft fees can afford to use those fees to underprice the front-end fees that consumers look at when selecting a card or to subsidize other features to lure consumers. Consumers who shop for prepaid cards will not calculate how much they might spend on overdraft fees; they do not expect to spend more than they have. They will not realize the hidden price tag that will add to the cost of a card that looks cheap or attractive for other reasons. Consumers will find themselves drawn to the most dangerous products.

Even issuers that want to resist adding overdraft fees may have a hard time doing so if others are reaping large profits from back end fees. Bankers who dislike overdraft fees on bank accounts have confessed in private that they cannot eliminate them from their checking accounts because consumers will not tolerate a monthly fee and shareholders will question why they have “left money on the table.”

A clear rule against overdraft fees or credit features will promote honest competition among prepaid card providers. It will drive them to compete on price and features that make their

¹⁰⁹ One prepaid card executive once boasted that demand for a credit feature was “insatiable and not price sensitive.” Research on payday loans has made clear that consumers do not generally choose the loans over other options based on price but instead based on other factors such as speed, convenience, guaranteed approval and being treated courteously.

prepaid card a better transaction product, not features that lead their customers to engage in repetitive, profitable credit transactions.

C. Permitting Credit Features on Prepaid Cards Facilitates Evasion of Consumer Protection Laws

1. Rent-A-Bank Payday Lending Will Return and Eviscerate State Payday and Usury Laws

If overdraft fees and credit features are permitted on prepaid cards, nothing will stop payday lenders from using the cards to evade state laws regulating interest rates and payday loans. Preemption issues, the complex multi-party arrangements underlying prepaid cards, and the complicated interplay between the credit and deposit features and the resulting fees will make it extremely difficult for states to defend the integrity of their laws. Efforts to use prepaid cards to evade payday laws are going on right now and need to be stopped cold.

A decade ago, payday lenders entered into a series of “rent-a-bank” partnerships with banks to take advantage of the banks’ preemption powers and extend payday lending into states where it was illegal.¹¹⁰ It took several years of enormous effort by advocates and bank regulators to end those partnerships. Every federal regulator whose banks were engaged in these schemes concluded that it was inappropriate for banks to lend their charters and assist payday lenders to evade state law.¹¹¹

A new form of rent-a-bank payday lending is now emerging by way of prepaid cards. As described in greater detail above, all of the following forms of credit are being made in states that have strict payday or usury laws, and perhaps to military borrowers:

- CheckSmart Insight Card payday loans, in partnership with Urban Trust Bank, at 390% to 401% in Arizona (36% rate cap) and Ohio (28% rate cap).
- TandemMoney prepaid card payday loans, in partnership with Insight Card Services (part owned by CheckSmart’s parent company), Urban Trust Bank and Premier Bank at 292% to 365%, apparently nationwide.
- SureCashXtra tribal prepaid card overdraft-style loans, in partnership with prepaid card payment processors, at 584%, apparently nationwide.

¹¹⁰ Jean Ann Fox, “Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury,” Consumer Federation of America (March 30, 2004).

¹¹¹ See generally National Consumer Law Center, *The Cost of Credit: Regulation, Preemption, and Industry Abuses* § 3.14 (4th ed. 2009 and Supp.)

- NetSpend ACE Elite™ Visa® Prepaid Debit Card issued by MetaBank offers up to \$100 in negative credit (including any \$15 overdraft fees incurred), resulting in an annual rate of over 2,000%.

It is also possible that U.S. Bank's account advance, with a 10-day APR of 365%, is available on the bank's prepaid cards.

Bank/prepaid card program manager/payday lender partnerships will not be as easy to stop as the older storefront rent-a-bank arrangements. Banks are an integral part of legitimate prepaid card operations, so it will be harder for regulators to divorce them from third party prepaid card companies than it was to force them out of their partnerships with payday lenders. Similarly, payday lenders and check cashers are legitimate outlets for selling prepaid cards, so if the CFPB does not ban predatory features on these cards it will be difficult for state or federal regulators to prevent their sale by payday lenders and check cashers as a vehicle for payday loans. Moreover, states will have a harder time going after prepaid cards with credit features than straight-out payday loans because the cards can offer credit features structured with fees that do not fit cleanly into state payday or usury statutes.

The only way to prevent prepaid cards from being used to undermine state laws is to prevent overdraft and other credit features on the cards.

2. The OCC's Guidance on Deposit-Related Credit May Encourage Preemptive Prepaid Card Payday Loans and Does Not Address Consumer Protection Concerns

Last year's proposed guidance by the Office of the Comptroller of the Currency on deposit-related credit products may spur other prepaid card providers to add payday loan features and complicate preemption issues. The proposed guidance was issued in response to bank account programs offered by Wells Fargo Bank and others, but it is equally applicable to prepaid card payday products like the defunct iAdvance line of credit.

The OCC guidance identifies a number of concerns about account advance products and useful principles that should apply to such products, whether connected to traditional bank accounts or prepaid cards:

- Failing to evaluate ability to repay;
- Requiring full repayment out of a single deposit, reducing funds for living expenses and causing overdrafts;
- Steering consumers who rely on federal benefits to high-cost products;

- Failing to monitor accounts for excessive usage and costs.¹¹²

But the proposed guidance does not apply those principles in a meaningful way.¹¹³ If finalized as proposed, the OCC guidance, issued by a bank regulator with a history of preempting state law, may merely justify the spread of bank and prepaid card payday products.

However, the OCC guidance was based on safety and soundness concerns, not consumer protection. The CFPB has a different mandate and responsibility.

The CFPB has the benefit of being able to act early, before abuses are widespread and before the rent-a-bank abuses of a decade ago return in a different form. *Make no mistake about it: if overdraft fees and credit features are permitted on prepaid cards, state payday and usury laws will not be worth the paper they are written on.*

3. Credit on Prepaid Cards Evades State and Federal Laws Protecting Benefits and Other Income Needed for Necessities

Numerous state and federal laws protect income that is needed for necessities from creditors. Public benefits such as Social Security, unemployment insurance, disability benefits, Temporary Aid to Needy Families, veterans' benefits, and pension income are typically exempt from garnishment by debt collectors.¹¹⁴ The Federal Trade Commission's Credit Practices Rule forbids waiver of these exemptions,¹¹⁵ explaining that the "reason for exemption laws is to afford minimal protection to debtors and their families by allowing them to retain the prime necessities of life, with a view to preserving the family unit and furnishing the insolvent with nucleus to begin life anew."¹¹⁶

A base amount of ordinary wages is also typically protected by both federal and state law. Under federal law, the maximum amount a debt collector can garnish is 25% of the borrower's disposable earnings for that week or the amount by which those earnings exceed 30 times the federal minimum hourly wage, whichever is less.¹¹⁷ Many states have laws that protect a greater amount.¹¹⁸

These laws protect a fundamental aspect of American democracy: the protection of debtors against merciless creditors. Debtors' prisons were abolished centuries ago, bankruptcy laws give individuals the ability to start fresh, and a wide variety of laws limit the ability of creditors to seize homes and funds needed for necessities.

¹¹² Office of the Comptroller of the Currency, "Proposed Guidance on Deposit-Related Consumer Credit Products," Docket ID OCC-2011-0012, 76 Fed. Reg. 33409 (June 8, 2011).

¹¹³ For comments describing the defects of the OCC guidance, see Deposit-Related Credit Comments to OCC.

¹¹⁴ See National Consumer Law Center, Collection Actions § 12.4 to 12.8 (2d ed. 2011).

¹¹⁵ 16 C.F.R. § 444.2(a)(2).

¹¹⁶ 49 Fed. Reg. 7740, 7768 (Mar. 1, 1984), codified at 16 C.F.R. Part 444.

¹¹⁷ National Consumer Law Center, COLLECTION ACTIONS §§ 12.4.1.1, 12.4.1.4.1 (2d ed. 2001).

¹¹⁸ *Id.* Appx. F.

Credit features on prepaid cards evade these protections. Overdraft loans and account advance products use setoff to immediately repay themselves off the top the minute the funds arrive, and other prepaid card credit features also require automatic repayment.¹¹⁹ The ability to grab the pay or benefit check enables the card issuer to defeat laws that protect funds that are needed to pay essentials.

As more and more public benefit recipients are being required to accept electronic payments, they need a safe place to receive their funds. As of March 2013, paper checks will be eliminated for virtually all recipients of Social Security and other federal benefits. A growing number of state programs as well are requiring recipients to choose between direct deposit and a limited functionality card with set terms.

Check cashers and payday lenders are eager to sign up these benefits recipients on prepaid cards that can siphon off their funds. As discussed above, many prepaid cards emphasize their ability to accept direct deposit of public benefits. And payday lenders are happy to make payday loans to those with regular benefit checks coming in.

Even the new Treasury Department rules, designed to enable all Social Security recipients to move to electronic payments, do not fully protect recipients. While the garnishment rule protects funds from third party creditors, banks and prepaid card providers continue to take overdraft fees out of benefit checks. The rule authorizing deposits to prepaid cards bans direct deposit to prepaid cards with lines of credit or loan agreements and is an important protection, but purveyors of overdraft fee and credit programs may claim they are not covered.¹²⁰

Enforcement of the Treasury prepaid card rule is also likely to be difficult and uneven. Treasury does not have enforcement authority, so enforcement is left to the card issuer's regulator. Regulators will need to examine each of the issuer's prepaid card programs to determine (1) whether the card receives direct deposit of federal payments, and (2) whether the card has credit features that trigger repayment from the deposit. The multiple parties involved with prepaid cards (not all of whom may be under the regulator's direct authority), as well as the cards' complicated structure, make examination of these questions and application of the rule complicated.

For example, the CheckSmart prepaid card payday loan involves at least three and probably four or more parties: Community Choice Financial, Inc. (CCF) (the owner of the CheckSmart chain of payday stores); Insight Card Services, LLC (the card program manager); Urban Trust Bank

¹¹⁹ A CheckSmart line of credit account agreement from 2010 is phrased to give the impression that the consumer is voluntarily electing electronic repayment, but it is likely that the consumer is required to sign the agreement and is not informed of other options. *See* NCLC CheckSmart Ltr to OCC at 7 & n.31.

¹²⁰ For example, the CheckSmart Insight Prepaid Card, which offers payday loans in the guise of overdraft fees at \$0.15 per \$1 negative balance, claims: "Your card is not a credit card and does not directly or indirectly access any credit feature or line of credit." <https://www.checksmartstores.com/services/ohio/> (footnote) (last visited July 15, 2012).

(the card issuer); and a “third party lender” that advances the credit (which is later purchased by a CheckSmart affiliate).¹²¹ The OCC (the bank regulator) can probably determine if federal direct deposits are being made to the card. But it may have to actively seek out information from the other parties to determine whether overdraft or credit features are being offered and how they are repaid.

Even the card issuer may have a hard time avoiding violations of the Treasury rule. For example, a consumer can list the routing number on a tax return, causing federal tax refunds to be deposited to the card in a manner that the card issuer may not be able to stop.

Violations of the Treasury rule can also be encouraged with a wink and a nod. One purveyor of a payday loan that is tied to prepaid cards¹²² requires consumers to click a box in the fine print to affirm: “I understand that Federal Law prohibits the use of Federally deposited funds in the calculation of my SureCashXtra loan. I also understand that Federal Law prohibits the use of Federally deposited funds to pay the principle, the fee, or any other aspect of my SureCashXtra loan.”¹²³ And yet nowhere in the FAQs does the lender say that the consumer is not eligible if she receives Social Security, SSI or other federal payments on the prepaid card. The person enrolling must merely “have at least 90 days of recurring direct deposit history on the qualifying prepaid card.”¹²⁴

Moreover, the Treasury rule protects only recipients of federal payments. There are no similar rules protecting recipients of state or local government benefits from having those benefits confiscated by credit features when the benefits are deposited to prepaid cards. It is virtually impossible for states to determine whether a direct deposit is going to a bank account or to a prepaid card.

Public benefits recipients are an especially vulnerable group who need every penny. Public policy also supports efforts to keep these publicly supported funds available for necessities. The same is true for those whose wages are low enough to be exempt from collection by creditors. Prepaid cards should not be used as a vehicle to evade laws that protect income needed for food and shelter.

4. Prepaid Card Credit Features Evade the Military Lending Act

The Talent/Nelson Military Lending Act protects service members and their dependents from dangerous credit products by capping rates at 36%, including fees. The regulations adopted by

¹²¹ For details, see NCLC CheckSmart Ltr to OCC at 5.

¹²² The funds are drawn on automatically if there are insufficient funds when an ATM withdrawal or purchase transaction is initiated. The FAQs explain: “Each branded prepaid debit card has a transaction processor that evaluates and completes ATM and Point of Sale Signature transactions that are performed on their cards. The transaction processor for your prepaid card must allow SCX to be enabled on their system.”
<https://mysurecash.com/FAQ.aspx> (last visited 7/23/12).

¹²³ <https://mysurecash.com/Apply.aspx> (last visited 7/23/12).

¹²⁴ <https://mysurecash.com/FAQ.aspx> (last visited 7/23/12).

the Department of Defense to implement the law cover only payday loans, refund anticipation loans, and auto title loans. The definition of “payday loan” includes several loopholes that can exclude payday loans that are styled as overdraft fees or account advances. The regulations exclude loans that are repaid by exercise of a depository institution’s right of offset; loans not subject to TILA disclosure requirements; and open-end loans.¹²⁵ Consequently, if overdraft fees or credit features are permitted on prepaid cards, the cards can be used to extend 300% loans to service members and evade the protections of the MLA.

5. Prepaid Cards with Credit Features are Credit Cards But Escape TILA’s Credit Card Protections

The Truth in Lending Act (TILA) has long recognized that if a card or other access device is used to access credit, then it is a credit card. The statutory definition of “credit card” is “any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit.”¹²⁶ The Regulation Z commentary makes clear that if a debit (or prepaid) card accesses a line of credit or other credit feature, it converts the card into a credit card protected by the general TILA credit card rules, whether the credit line is accessed to purchase goods and services or at an ATM to get a cash advance.¹²⁷

However, prepaid card credit features evade TILA protections. First, as discussed above, overdraft fees are not treated as finance charges (the triggering requirement for most TILA rules) and do not require TILA disclosures. Second, the protections added to TILA by the Credit CARD Act of 2009 also do not apply to “an overdraft line of credit accessed by a debit card.”¹²⁸ Third, recent amendments to the definition of “credit card” in Regulation Z exclude an account number that is used to transfer funds into another account.¹²⁹ Thus, prepaid card credit features evade TILA protections whether they draw on credit directly when used, through overdraft coverage, or through a two-step process by which credit is first transferred to the card and then spent.

Consequently, prepaid card credit features are likely to escape numerous important TILA protections for credit, including:

- APR disclosures.
- Ability to pay requirements.
- Reasonable and proportional rules for overdraft and other penalty fees.

¹²⁵ See 32 C.F.R. §§ 232.3(b)(1)(i), (b)(2)(v).

¹²⁶ 15 U.S.C. § 1602(l).

¹²⁷ See Official Staff Commentary on Regulation Z, 12 C.F.R. pt. 226, Supp. I, § 226.2(a)(15)-2.i.A through -2.i.B.

¹²⁸ 12 C.F.R. § 226.2(a)(15)(ii)(B). The term “overdraft line of credit” is not defined in TILA and should not be read to apply to fee-based, single-payment credit lines. See Overdraft Comments to CFPB at 33.

¹²⁹ See Official Staff Commentary on Regulation Z, 12 C.F.R. pt. 226, Supp. I, § 226.2(a)(15)-2.ii.C.

- A ban against using offset against a deposit account to pay credit card debt.
- The cap on fees that exceed 25% of the credit line in the first year.
- Chargeback rights against merchants.
- A ban against retroactive changes in fees or rates.
- Periodic statement requirements.

Indeed, the H&R Block Advance offered through its prepaid card is a credit card in all but name. The only difference between the Advance and a credit card is that the credit must be transferred to the prepaid card before being spent. Yet that difference – use of an account number to transfer the money to a deposit account – may suffice to take it out of TILA protection.

Though the Advance appears to be complying with credit card rules, its structure could be mimicked by less scrupulous credit card issuers to evade TILA. The CFPB must ensure that this does not happen.

There is nothing to prevent a prepaid card issuer from also offering a consumer a credit card. But the credit card should be issued separately, as a separate account, fully subject to the rules governing credit in general and credit cards in particular.

The elaborate regulatory framework and consumer protections that have been developed over the years to protect credit will be evaded if providers are permitted to offer credit in a confusing, unregulated manner combined with other products.

6. The CFPB May Not Be Able to Examine or Bring Enforcement Actions Against Many Prepaid Credit Providers

The CFPB might hope that it can control any unfair, deceptive or abusive practices, or evasions of other laws, by keeping a vigilant eye on any prepaid cards that have overdraft fees or credit features. But most of those cards will be out of the CFPB's oversight.

Banks with assets exceeding \$10 billion – the only banks that come under the CFPB's oversight – are already barred by federal law from charging overdraft fees on prepaid cards. These largest banks are also unlikely to use be interested in risking violations of the Treasury Department rule against direct deposit of federal payments to cards with credit features. Thus, it is only banks with assets under \$10 billion – those outside the CFPB's supervisory jurisdiction – that would be likely to take advantage of a rule that did not ban overdraft and credit features on prepaid cards. Vendors who wish to tempt prepaid card consumers with credit features will choose a bank issuer that is not subject to CFPB examination.

The CFPB may have authority over some prepaid card program managers, but even that is uncertain. The largest program manager, Green Dot, is now a bank holding company and no longer subject to CFPB examination. Though Green Dot has disavowed credit features, other program managers are likely to try to follow suit and purchase their own issuing bank to escape CFPB supervision.

Even for program managers that are not bank holding companies (or bank subsidiaries), the CFPB only will have supervision authority over the larger participants in the market. Smaller programs, with less concern for their reputations and less established compliance regimes, may cause some of the biggest problems.

The other regulators will be on the lookout for unfair, deceptive or abusive practices. But none of the other agencies has the multi-featured, robust consumer protection functions or mandate that the CFPB does. They do not have market groups studying prepaid cards and a variety of credit products; an experienced rule writing staff with deep experience with consumer protection regulations; a consumer outreach division with special offices focusing on special populations; or direct authority over the nonbank prepaid card program managers that will partner with smaller banks (unless they are an affiliate of the bank). There is also the risk of different standards used by different regulators.

On the other hand, a clear CFPB rule against credit features will apply to everyone and can be easily enforced no matter who the regulator is. A clean rule will protect all consumers equally no matter who issues or manages their prepaid card.

D. Opt In to Credit Features Is Not Sufficient to Protect Prepaid Card Users or Necessary to Ensure Choice

1. Opt In Does Not Protect Prepaid Cards Users From the Dangers of Credit Features

Industry providers may argue that those who do not want overdraft or credit features on their prepaid cards can choose a card that does not have those features. But “opt in” is not a sufficient response to concerns about unfair, deceptive, abusive practices or the other concerns outlined above. Almost every product is “opt in” – the consumer has chosen to use it. That does not mean that certain features should not be banned on certain products.

Permitting credit on an opt-in basis does not protect vulnerable consumers from predatory lending or the dangers of credit extended irrespective of ability to pay. While we believe that the failure of the Regulation E opt-in overdraft fee rules demands reform for checking accounts as well, reliance on opt-in to protect consumers would be especially misguided in the context of prepaid cards and prepaid card consumers, for all of the reasons outlined above. These factors

demand a rule that prepaid cards remain true to what they are and who they are aimed at: prepaid, without the dangers of overdraft or credit products.

As described above, the inherent nature of prepaid cards, and the reason they are appropriate for the consumers who use them, is the *prohibition* of credit, the inability of consumers to get into trouble by overspending or overdrafting. Opt in rules, or rules that permit credit features to be added to prepaid cards, defeat this very essence of prepaid cards.

Moreover, issuers will manipulate opt-in and optional credit features, just as they have with bank accounts.¹³⁰ They will raise the specter of access to credit for emergencies, but design it for an everyday debt trap, engaging in unfair, deceptive or abusive practices that will be impossible for the CFPB to control.¹³¹ Not every manipulation will be susceptible to legal charges of being deceptive; clever industry players are more subtle and careful, but they are effective in manipulating consumers nonetheless. Even when legal lines are more clearly crossed, the CFPB has limited resources.

The CFPB can either have a clear rule that prepaid cards cannot have overdraft fees or other credit features, or it can wage an endless war on a billion fronts to stop all of the pernicious problems described in these comments. It will lose that war.

2. If Appropriate, Credit Can Be Provided Through Separate Credit Accounts, But Protections Are Needed to Avoid Evasions

A rule banning overdraft fees and credit features on prepaid cards does not mean that prepaid card holders cannot be offered credit through accounts. Credit *features* of the prepaid card account – such as “overdraft protection” and advances within the account – should be prohibited. But an institution could offer separate, freestanding credit accounts to their prepaid card holders.

In order to protect prepaid card holders and avoid evasions of numerous laws, the CFPB should adopt the following steps. Otherwise, any rule will be circumvented merely by styling the credit feature as a separate product.

First, overdraft fees and overdraft “protection” should be banned on prepaid cards, as well as any other form of credit accessed directly by the card. Prepaid cards should not be

¹³⁰ Examples include: “Please keep in mind that this option [not opting in] may prevent you from completing everyday transactions including Any store and gas station purchase, Emergency home and car repair...Purchases when traveling, Medical or health emergencies,” and “The Bounce Overdraft Program was designed to protect you from the cost and embarrassment of having your transactions denied. “ Center For Responsible Lending, “Banks Collect Overdraft Opt-ins Through Misleading Marketing: Survey finds low opt-in rate, high number of misperceptions” (April 2011), available at <http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/banks-misleading-marketing.html>.

¹³¹ As discussed in our overdraft comments, opt-in rates for overdraft programs do not demonstrate that consumers want overdrafts, and even if they did, it certainly does not justify these programs in the context of prepaid cards. Overdraft Comments to CFPB at 14-16.

permitted to offer credit through the guise of overdraft fees under Truth in Savings and EFTA rules, nor any other form of credit that can be accessed through the card, as through automatic transaction approval and overdraft coverage of overdrawn transactions. This is consistent with the Regulation Z rule that a card that is used to access a line of credit or other credit feature, whether to purchase goods or services or access cash, is considered a credit card.¹³²

The rule will need to **apply to payment processors** as well as the card issuers and program managers, and prevent credit features that work like overdraft programs, where the credit is accessed automatically. For example, the tribal SureCashXtra payday loans discussed in section II.A.4 above work through the transaction processor.

In order to bolster this rule, and prevent debit cards from also avoiding credit card rules, the CFPB should repeal the exemption from TILA's Credit CARD Act provision for "an overdraft line of credit accessed by a debit card."¹³³ To the extent it is retained, it should be limited to amortizing installment products and to lines of credit that can be accessed only by check or ACH payment, not by debit, prepaid or ATM card.¹³⁴

Second, a particular provider can offer both prepaid cards and credit products, but it is essential that there be conditions on how it does so. Otherwise, state and federal credit rules will be evaded and the same unfair, deceptive and abusive practices described above will occur. These rules should apply to any product jointly marketed or packaged with another institution in order to prevent evasions. The Tandem Money prepaid card, for example, involves at least three different parties.

These conditions are:

- The credit account and the prepaid card are fully separate accounts.
- The credit account complies with all applicable credit laws.
- The credit is based on ability to pay, not ability to collect.¹³⁵
- The credit is repayable in installments, not as a single balloon payment.¹³⁶

¹³² See Official Staff Commentary on Regulation Z, 12 C.F.R. pt. 226, Supp. I, § 226.2(a)(15)-2.i.A through -2.i.B.

¹³³ 12 C.F.R. § 226.2(a)(15)(ii)(B).

¹³⁴ The term "overdraft line of credit" is not defined in TILA and should not be read to apply to fee-based, single-payment credit lines. See Overdraft Comments to CFPB at 33.

¹³⁵ To the extent that the credit account is considered a credit card – as it should be – it must comply with the TILA ability to repay provision. In addition, the rules against unfair, deceptive and abusive practices would also dictate that any credit be based on ability to repay.

¹³⁶ Single payment loans are designed to evade the Regulation E protection against mandatory electronic payment, and are not consistent with ability to repay. To the extent that the credit accounts are considered credit cards – as they should be – they must comply with the credit card provisions of TILA, including ability to repay. In addition, the rules against unfair, deceptive and abusive practices would also dictate that credit be based on ability to repay.

- The credit is not required to be repaid automatically from the deposits held on the prepaid card, whether through authorization for an electronic fund transfer, a remotely created check, or some other method.
- Consumers may choose to repay the credit automatically but the choice must be truly voluntary, not the default method, not coerced or manipulated in any way, and revocable, consistent with the EFTA.¹³⁷ Any incentives for automatic repayment must be modest.¹³⁸
- The prepaid card does not charge any fees that are disguised credit charges or otherwise related to the credit.
- The credit complies with applicable state law payday loan or usury laws; if offered by a depository institution that is exempt from such laws, no part of the revenues may be shared with a nonbank and the credit risk may not be sold to or shared with a nonbank.
- An anti-evasion rule prohibits any interaction between the credit product and prepaid card that evades other laws or results in any unfair, deceptive or abusive practices. For example, any arrangements that involved federal payments or state public benefits should be closely scrutinized and discouraged.

These rules are necessary to avoid manipulations that evade legal protections. Of course, there are other elements to an affordable small loan, such as a 36% rate cap, and a 90-day or longer term.¹³⁹

It is particularly important that the CFPB do more to support the integrity of the existing EFTA rule banning credit conditioned on a preauthorized electronic fund transfer. The CFPB should amend this provision of Regulation E so that it applies to single payment loans.¹⁴⁰

¹³⁷ The EFTA gives consumers the right to stop preauthorized electronic fund transfers. 15 U.S.C. sec. 1693e(a).

¹³⁸ For example, some credit unions discount a 21% APR loan to 19% if the consumer uses automatic repayment. See NCLC, “Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don’t at 20, 30-31 (June 2010), available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf. That modest incentive complies with Regulation E. See Official Staff Interpretations of Reg. E, 12 C.F.R. Pt. 1005, Supp. I, §1005.10(e)-1. Wells Fargo, on the other hand, requires a coercive \$100 payment for consumers who elect to repay their account advances by mail. See https://www.wellsfargo.com/help/faqs/dda_faqs (“How is my advance repaid if using Payment by Mail?”). Similarly, as discussed above, Tandem Money requires a \$50 payment to “revoke” authorization for automatic repayment, which appears to be the default payment method. See Pinkett v. First Citizens Bank, 2010 WL 1910520 (N.D. Ill. May 10, 2010) (creditor may not mandate electronic repayment as the default method).

¹³⁹ See generally “Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don’t (June 2010), available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

¹⁴⁰ Even without an amendment, the CFPB should make clear that loans that are purportedly styled as single payment loans are covered by the ban on compulsory electronic repayment if the payments on repeat loans recur at regular intervals, such as upon receipt of a direct deposit. See *Mitchem v. GFG Loan Co.*, 2000 WL 294119 (N.D. Ill. Mar. 17, 2000); *Johnson v. Tele-Cash, Inc.* 82 F. Supp. 2d 264 (D. Del. 1999). An occasional cooling off period or skipped month should not be enough to avoid this rule.

Automated payment cannot be the default method,¹⁴¹ the choice must be truly voluntary, affirmative and not coerced or buried in fine print. The consumer must be able to revoke authorization or stop payment, as permitted by the EFTA, without charge. The existing commentary, which permits a discount in the interest rate for the loan to encourage automatic repayment,¹⁴² needs to be clarified to emphasize that the discount must be modest and fees cannot be used to coerce the choice.

The H&R Block Emerald Advance is an example that appears to comply with our proposed rules.¹⁴³ The Advance is linked to the H&R Block prepaid card in two respects: holding a prepaid card is a requirement for the Advance, and the card is the means of distributing the funds. But in all other respects, the Advance is a fully separate account that follows credit laws. It is effectively set up like a credit card: it comes with statements; payments are due on a set day of the month based on the statement; payments are not required to be transferred from the prepaid card; payments are amortizing, installment payments (the greater of \$40 or 4% of the outstanding balance); and the prepaid card does not charge any unusual fees that are related to the credit or receipt of the advances. The authorization forms on the website make very clear that automatic payment is optional; authorization is not slipped in through the fine print.

On the other hand, the CheckSmart line of credit, described in section II.A.2 above, does not follow these rules and is merely a method of evading credit laws. It is a single, balloon payment loan that is repaid automatically from deposits on the prepaid card;¹⁴⁴ the card charges a “courtesy transfer fee” when the credit is loaded, which is a method of disguising the APR and avoiding state usury laws; and the balloon payments are evidence that the credit is not based on ability to repay.

Similarly, the Tandem Money line of credit requires automatic repayment and for some consumers is structured as a single payment loan. The arrangement with a separate issuer for the Tandem Money prepaid card appears designed to evade (or, rather, violate) the Treasury rule governing direct deposit of federal payments.¹⁴⁵ Though the loans purport to be made by a depository institution immune from state interest rate caps, there may be risk-sharing arrangements and the structure may be a vehicle for state regulated parties to avoid state payday or usury laws.

¹⁴¹ See *Pinkett v. First Citizens Bank*, 2010 WL 1910520 (N.D. Ill. May 10, 2010) (creditor may not mandate electronic repayment as the default method).

¹⁴² Official Staff Interpretations of Reg. E, 12 C.F.R. Pt. 1005, Supp. I, §1005.10(e)-1.

¹⁴³ We do not know how H&R Block considers ability to pay or whether the advance, in practice, creates problems that could be deemed unfair, deceptive or abusive or evasion of consumer protection laws.

¹⁴⁴ The paperwork makes the authorization for electronic repayment appear optional but it is almost certain that consumers are led to believe that they must sign it.

¹⁴⁵ A customer service representative said that a consumer who receives federal disability income would be eligible for the loan.

If the CFPB agrees that prepaid cards should not have embedded credit features, then it must ensure that any rule is not evaded by styling the credit as a separate account. When both prepaid card and credit products are offered by the same provider, in particular, opportunities for manipulation abound. The conditions outlined above will permit credit to be offered to prepaid card consumers without violating the safety and sanctity of the deposits on the prepaid card.

E. CFPB Has Authority to Ban Overdraft Fees and Credit Features on Prepaid Cards

The CFPB has authority in a variety of places to address overdraft fees and credit features on prepaid cards.

1. UDAAP Authority

The CFPB has authority to address unfair, deceptive or abusive acts or practices. That authority includes the authority to *prevent* such practices, even if every act or practice covered is not *per se* unfair, deceptive or abusive.¹⁴⁶ As described above in detail, overdraft fees and credit features on prepaid cards are unfair, deceptive or abusive for a variety of reasons.

It is deceptive to offer a “prepaid” card that is not prepaid; that includes credit that is not priced, disclosed, and regulated like credit; that purports to protect consumers in an emergency when it does not; that claims to be for unusual expenses and to be a short term loan but is structured to encourage regular, routine use over a period of time; that sells “overdraft” protection on a product that does not have overdraft capacity; that leads to less spending power instead of enhancing net available income; that has a deceptively low up front price tag that does not take into account the likelihood of back-end overdraft and credit charges; and that functions as a modern-day wage assignment that cannot be cancelled.

There are a myriad of ways in which the marketing, selling, disclosure and explanation of prepaid cards is fundamentally inconsistent with credit. The CFPB cannot possibly draft detailed enough rules, or take enough supervisory or enforcement actions, to prevent deception if prepaid cards and credit are mixed.

Overdraft fees and credit features on prepaid cards are also unfair. Every overdraft fee causes injury to consumers and those fees add up substantially, especially for the low income consumers who use prepaid cards and need every dollar. It also causes substantial injury to offer exorbitantly expensive credit without consideration of ability to repay, particularly to a population that is likely to have trouble managing credit and is unlikely to have the resources to repay that credit without digging into income needed the following month. It causes substantial injury to offer credit that takes the first cut of the next wage or public benefit check, before necessities such as food, rent and medicine are paid for, evading laws that protect income needed

¹⁴⁶ See 12 U.S.C. § 5531(b) (CFPB “may include requirements for the purpose of preventing such acts or practices.”)

for necessities. It causes substantial injury to offer credit at rates in excess of those permitted by state law.

Consumers cannot reasonably avoid these injuries. Opt in has not worked for overdraft fees on checking accounts and it will work even worse on prepaid cards. Banks and prepaid card companies have misled consumers about whether overdraft coverage is necessary, the consequences of declining it, and the escalating cost (with little to no long term net benefit) of accepting it.

Overdraft fees and credit features on prepaid cards are also abusive. They materially interfere with consumers' understanding of what a prepaid card is and how it works. They take unreasonable advantage of vulnerable consumers' lack of understanding of the material risks, costs and conditions of accepting these dangerous forms of credit, discussed at great length above. In some instances, such as with payroll cards, consumers do not have the ability to protect their interests by selecting a different product, as they are automatically enrolled in a specific product they do not choose. Consumers also reasonably rely on the representations of prepaid card companies that tout overdraft and credit features that such features are in their best interest and are a good idea, when the companies do not fully explain the risks and consequences of such features.

2. EFTA and Regulation E

The CFPB also has the authority under the EFTA and Regulation E to protect the integrity of deposit accounts. Overdraft fees and credit features on prepaid cards undermine the integrity of deposit accounts and interfere with a number of policies underlying the EFTA and Regulation E.

a. Ban on Compulsory Electronic Repayment

The EFTA prohibits creditors from conditioning credit on payment by preauthorized electronic funds transfer. Yet prepaid card credit features require the consumer to authorize automatic electronic repayment. Although Regulation E exempts overdraft protection plans from the ban on mandatory electronic repayment, that exemption is not in the statute. The exemption should not be extended to prepaid cards, and the current application to checking accounts should be repealed. The exemption was based on a rationale that is no longer valid.¹⁴⁷

¹⁴⁷ The exception was adopted in 1981, based on the finding that “there is little evidence of consumer complaints” involving automatic transfer under overdraft credit plans.” 46 Fed. Reg. 2972, 2973 (Jan. 13, 1981). That may have been true of the installment, APR-based lines of credit that were common in 1981, but it is certainly not true today of fee-based overdraft plans.

The CFPB has the authority to require prepaid cards to comply with the statutory ban on mandatory electronic repayment.¹⁴⁸ There is no reason for an exemption to encourage overdraft plans for an account that does not offer unfunded checks that need overdraft protection.

Even when preauthorized transfers are authorized, the EFTA gives consumers several important rights. Consumers have the right to advance notice when a payment will vary in amount and the right to stop payment.¹⁴⁹ Yet prepaid card credit products are designed to evade those protections by being structured in a manner that they are not covered by the preauthorized transfer rules.¹⁵⁰

The CFPB can prevent evasions of the rules governing preauthorized transfers by requiring that credit be offered through separate credit accounts and not within the deposit account. Clear separation between those two types of accounts will avoid confusion and regulatory arbitrage when credit and deposit products are mixed.

b. Modifications of EFTA Requirements

The CFPB also has the authority to impose conditions on any modifications to Regulation E, which are discussed on section III.B.1 below. A clear ban on overdraft fees and credit features is far preferable and will prevent evasions and an uneven playing field. But at a bare minimum, any cards that pose the risk of triggering overdraft fees or putting the consumer into debt with an obligation to repay that debt should be subject to full statement requirements – both under Regulation E and, as discussed below, under TILA and Regulation Z. These statutes require written statements, and the CFPB has authority to determine the circumstances under which they can ignore those statutory requirements.

3. TILA and Regulation Z

The CFPB has authority to ban overdraft fees and credit features on prepaid cards under the authority of a number of provisions of the Truth in Lending Act and Regulation Z.

¹⁴⁸ As discussed in sections II.B.& & II.E.2 above, any overdraft or credit feature that may result in repeat usage, and trigger recurring payments at intervals determined by deposit of the consumer's wage or benefit check should fall within the definition of "preauthorized electronic fund transfer." Moreover, the CFPB should extend the ban on mandatory electronic repayment to single payment loans, which were not envisioned in 1974 when the EFTA was written.

¹⁴⁹ See 15 U.S.C. § 1693(a), (b).

¹⁵⁰ The EFTA protections for preauthorized transfers apply only to transfers authorized in advance to recur at regular intervals. Prepaid card credit features are structured as one-time single payment loans, and also as overdraft lines of credit, which are exempt from the ban on mandatory electronic repayment. Prepaid card credit features may also be repaid by offset, not by electronic fund transfer. See National Consumer Law Center, Consumer Banking and Payments Law § 4.11.1 (Supp. 2011).

TILA's central mandate is to promote a uniform means of comparing the cost of credit.¹⁵¹ TILA was adopted for the specific purpose of helping consumers to compare different credit products with different structures.¹⁵² Yet credit products offered through overdraft fees and open-end, single payment account advances are designed to avoid disclosing an APR and to be priced and sold in a manner that prevents comparisons to other types of credit that can be used to cover shortfalls. Banning credit features that are embedded in deposit accounts and requiring credit to be offered through separate credit accounts that have APR disclosures are consistent with TILA's central purpose.

Cards that are linked to deposit accounts with credit features have also long been viewed as "credit cards" under Regulation Z. Yet, as discussed above, permitting overdraft or credit features on prepaid cards undermines a variety of provisions governing credit cards and other forms of credit. Here again, the CFPB has authority to require credit to be offered through separate credit accounts that comply with credit laws. In order to avoid circumvention of numerous provisions of TILA and to promote TILA's purposes, overdraft fees and credit features should be banned on prepaid cards.

At a bare minimum, the CFPB should require any credit features on prepaid cards to comply with appropriate TILA provisions.¹⁵³ In particular, the CFPB should require any prepaid card credit features – whether styled as overdraft fees or directly as credit – to comply with the following provisions:

- APR disclosures.
- Ability to pay determination requirements.
- Reasonable and proportional rules for overdraft and other penalty fees.
- A ban against using offset against a deposit account to pay credit card debt.
- The cap on fees that exceed 25% of the credit line in the first year.
- Chargeback rights against merchants.

¹⁵¹ See 15 U.S.C. § 1601(a); Elizabeth Renuart & Diane E. Thompson, "The Truth, The Whole Truth, and Nothing but the Truth: Fulfilling the Promise of Truth in Lending," 25 Yale J. on Reg. 181 (2008).

¹⁵² *Id.*

¹⁵³ If the CFPB continues to permit overdraft fees to be exempt under current Regulation Z rules, it should follow those rules and regard the fee as a finance charge "to the extent it exceeds the charge for a similar account without a credit feature." 12 C.F.R. § 226.4(b)(2). That is, unless the prepaid card carries denied transaction fees and does not exceed those fees, the overdraft fee should be considered a finance charge. (However, the CFPB should agree with the FRB's suggestion that denied transaction fees are unfair, *see* 74 Fed. Reg. 59033, 59041 (Nov. 17, 2009), and certainly should not permit issuers to charge large denied transaction fees as an excuse for justifying overdraft fees.)

- A ban against retroactive changes in fees or rates.¹⁵⁴
- Periodic statement requirements.

4. Mandate to Preserve Access to Safe Financial Products

Among the CFPB’s mandates, Congress directed the Bureau “to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services”¹⁵⁵

Keeping prepaid cards as a safe form of transaction account for consumers who have been excluded from or had difficulty with bank accounts is important to ensure that these consumers have access to transactions accounts. As discussed above, checkless accounts without overdraft capacity or overdraft fees are viable accounts for consumers with blemished histories and need to stay that way.

III. Regulatory Coverage of Prepaid Cards

A. All GPR Cards Should be Protected by Regulation E

1. The Importance of Regulation E Protections

All general purpose reloadable (GPR) cards should be covered by the protections of the Electronic Funds Transfer Act (EFTA) and Regulation E. Regulation E provides consumers with critical protections, including:

- Protection against liability due to loss, theft, and unauthorized charges;
- Dispute rights in the case of errors;
- A right to account information, including transaction history and balances;
- Disclosure of terms and conditions and fees;
- A ban on credit conditioned on mandatory electronic repayment;
- Protection from overdraft programs imposed without consumer consent.

Each of these is a critical protection and should apply to all GPR cards.

¹⁵⁴ Given that current prepaid card credit features are typically short-term, single payment loans, protections against retroactive changes might seem unnecessary. However, the H&R Block Advance is one example of a prepaid card credit feature with long term payments that mimic traditional credit cards and needs credit card protections.

¹⁵⁵ 12 U.S.C. § 5511(a).

Consumers who use general use, reloadable prepaid cards must be confident that they are protected if they lose the card, it is stolen, or there are unauthorized charges. General use cards are attractive subjects of identity theft, which is a growing problem. The liability protections of Regulation Z and E have gone a long way to give consumers confidence when using cards to buy goods and services and when conducting business over the internet.

Mobile devices can also be a virtual prepaid card or can access a physical card, as discussed below. The growing popularity of smart phones as a means of internet access, and widespread concerns about the security of those devices, make liability protections all the more essential.

When problems arise or mistakes happen, legally specified dispute rights are critical. Vague, unenforceable voluntary assurances are not enough. When push comes to shove, consumers need to know exactly what rights they have and be able to enforce those rights. Clear, across-the-board protections will protect the industry from unscrupulous practices of some that will undermine consumer confidence in all prepaid cards.

We understand that some concerns have been raised by industry about the potential for consumer fraud if prepaid cards must comply the Regulation E error resolution protections, including the 10-day right of recredit. At the outset, this concern leads us to question the repeated assurances we have been given over the years that GPR cards already voluntarily comply. Moreover, fraud can be a problem on credit and debit cards too, and those problems are not insurmountable. The comments of Reinvestment Partners outline a number of steps issuers can take to avoid fraud, including limiting the amount of funds that can be loaded on a card before validation, requiring identification before accepting a dispute, checking with credit reporting agencies, and reporting fraud to prosecuting authorities.

Account information, including access to balances and transaction histories, are of course essential for any reloadable product. Consumers need this information to manage their accounts and to ensure they are not the subject of deceptive practices. Full disclosure of terms and conditions and of fees is of course indispensable.

To the extent that overdraft fees or credit features are permitted, the Regulation E opt-in rules are a bare minimum protection, and the EFTA also includes important protection for deposit accounts by banning creditors from conditioning credit on payment by preauthorized electronic fund transfer. Prepaid card users need that protection as much as or more than other consumers.

Low balance cards that have a more limited use, such as gift cards and nonreloadable cards, may not need the full suite of Regulation E protections. But any card that can be reloaded and used at a variety of unaffiliated locations should receive Regulation E protection.

2. Definition of “Prepaid Card”

The CFPB will need both a broad and a narrow definition of prepaid card. The broad definition will ensure that all cards and their equivalents (such as web or mobile based systems) are required to comply with Regulation E. However, if any modifications to Regulation E are adopted, we recommend that the CFPB define a narrower subcategory of “qualified prepaid cards” that can follow any modified rules regarding periodic statements.

A working definition should expand the definition of “account” under Regulation E¹⁵⁶ as follows:

(b)(1) Account means a demand deposit (checking), savings, or other consumer asset account (other than an occasional or incidental credit balance in a credit plan) held directly or indirectly by a financial institution and established primarily for personal, family, or household purposes.

(2) The term includes:

(i) a “payroll card account” which is an account that is directly or indirectly established through an employer and to which electronic fund transfers of the consumer’s wages, salary, or other employee compensation (such as commissions), are made on a recurring basis, whether the account is operated or managed by the employer, a third-party payroll processor, a depository institution or any other person. ~~For rules governing payroll card accounts, see § 1005.18.~~

(ii) a “general purpose reloadable prepaid card account,” which is an account that:

(A) uses an access device to access a subaccount of an account at a financial institution or an account that is provided or held by a person that is not a depository institution;

(B) is reloadable;

(C) is usable at multiple, unaffiliated merchants for goods or services or at automated teller machines; and

(D) is capable of holding \$500 or, if capable of holding less than \$500, is not marketed or labeled as a gift card or gift certificate.

(3) The term does not include an account held by a financial institution under a bona fide trust agreement.

¹⁵⁶ 12 C.F.R. § 1005(b).

This definition has been designed in an attempt to capture all GPR cards in a way that does not overlap with traditional bank accounts and does not permit prepaid card issuers to avoid the definition by structuring their accounts as individual accounts. The definition captures cards where the funds are held by a nonbank, OR the card is provided by a nonbank. The definition also requires smaller balance reloadable cards either to be clearly labeled as gift cards, and to comply with the Regulation E gift card rules, or to be regulated as GPR cards.¹⁵⁷ We encourage the CFPB to evaluate carefully whether the definition achieves these purposes, and to tighten it if necessary.

This definition will apply for purposes of requiring compliance with Regulation E. In addition, as discussed in section III.B.1 below, if the CFPB adopts any modifications to Regulation E, a narrower definition of “qualified prepaid cards” should limit the cards that do not need to comply with full statement requirements and can instead follow modified rules. In other words, all GPR cards, as defined above, would be covered by Regulation E. But only qualified cards could follow modified rules. That narrower definition and the rationale for it are discussed in section III.B.1 below.

The definition of “financial institution” does not appear to need amendments. The current definition is:

- (i) Financial institution means a bank, savings association, credit union, or any other person that directly or indirectly holds an account belonging to a consumer, or that issues an access device and agrees with a consumer to provide electronic fund transfer services.¹⁵⁸

As long as the definition of “account” includes GPR accounts as discussed above, prepaid card providers should come within the reference to “person” in the definition above.

3. The CFPB Should Work with the FRB to Adopt a Common Definition of “Prepaid Card” that is Not Unduly Limited

Just as the CFPB must define “prepaid card” in a manner that does not encompass bank accounts, the Federal Reserve Board (FRB) struggled to do the same in the Regulation II provision governing the exemption for prepaid cards from interchange fee caps. Retailers in particular were concerned that banks would simply turn their bank accounts into prepaid cards in order to exploit the exemption and evade interchange fee regulations.

In order to address this concern, the FRB adopted limitations in Regulation II on the features of prepaid cards that qualify for the exemption.¹⁵⁹ Those limitations were adopted in the final rule

¹⁵⁷ Rebate cards are exempt from the gift card rules and are not reloadable so are not GPR cards.

¹⁵⁸ 12 C.F.R. § 1005.2(i).

¹⁵⁹ These rules are discussed in National Consumer Law Center, Consumer Banking and Payments Law § 7.2A.2 (Supp. 2012)

and were not the subject of notice and comment. Our groups and others would have expressed concerns about the restrictions if given the chance.

The FRB should revisit those limitations and work with the CFPB to develop a common definition that does not unduly restrict prepaid cards. The definition of “qualified prepaid card” suggested in these comments could be used as a uniform definition that separates prepaid cards from bank accounts and prevents evasions of both the Regulation E statement rules and the Regulation II interchange fee cap.

Regulation II extends the interchange fee exemption to GPR cards account only if the prepaid card is the sole means of accessing the funds, not checks, transfers to other accounts, or other methods.¹⁶⁰ Thus, prepaid cards are ineligible for the interchange fee exemption if they have:

- Bill payment features;
- Capacity to make automated clearinghouse (ACH) transfers;
- Checks, such as the pre-funded checks available on some payroll cards;
- The ability to transfer funds to another account, including a savings account;
- Capacity to remit funds to another location.

While retailers’ concern about evasions was understandable, these restrictions unduly restrict the functionality of prepaid cards. For the low income or credit impaired consumers who are shut out of bank accounts or cannot manage them, prepaid cards need to be a functional transaction account. Consumers need to pay landlords, babysitters, and others who do not accept cards. Bill payment features help consumers to manage their finances and keep track of bills. As innovations continue to develop on prepaid cards, the FRB restrictions will limit the transactional capability of these cards.

The prohibition on attached savings account is especially troubling. Prepaid card users are precisely the group that should be encouraged to save. Regulations should encourage automated savings programs and other savings features, not prohibit them.

Prepaid cards subject to Regulation II also cannot be used for remittances, whether across town or across the world, and still benefit from the interchange fee cap exemption. Many prepaid card users have friends or family in this country or in other countries to whom they need to send money. Indeed, many remittances are domestic.

¹⁶⁰ Reg II., 12 C.F.R. § 235.5(c)(1)(i), (iii). These limitations are discussed in the FRB’s Frequently Asked Questions -- Regulation II, available at http://www.federalreserve.gov/paymentsystems/regii_faq.htm; see also 76 Fed. Reg. 43394, 43438-39 (July 20, 2011).

Interchange revenue is the primary source of income on prepaid cards. Banks that are subject to Regulation II cannot afford to ignore its requirements. Thus, all prepaid cards issued by banks over \$10 billion can be expected to comply with those restrictions.

The new Chase Liquid card, for example, has few fees, permits full access to the Chase ATM and branch network for free deposits and withdrawals, and is a positive addition to the prepaid card market. Yet the card does not have bill payment capacity and consumers cannot make transfers to a savings account. Those limits are the result of Regulation II, not decisions by Chase.

The Regulation II limits on prepaid card functionality will also drive program managers to use smaller banks as their card issuers, which will undercut the Regulation II prohibition on overdraft fees and the requirement to offer one free ATM withdrawal per month.¹⁶¹ Banks under \$10 billion are not subject to interchange fee caps and can issue prepaid cards without complying with any of the Regulation II requirements.

In addition to the restrictions on GPR cards, Regulation II also imposes restrictions on government benefit cards that wish to enjoy the exemption from the interchange fee cap. The cards are eligible only if they cannot accept deposits of funds from sources other than the government agency.¹⁶²

Though most government benefit cards currently on the market are limited to government funds, policymakers have been exploring adding deposit capacity to some cards. The cards would be more functional for consumers who have other sources of income if they could be used as a central account.

For example, the Direct Express Card issued by Comerica Bank and used to pay Social Security and other federal payments currently only accepts government funds. But the card would be more useful if consumers could deposit pensions and other income to the card and use it as their primary account. Instead, they must either maintain two accounts or continue to receive paper checks from their other income source.

In addition, government agencies have been exploring whether they can use the delivery of government payments through prepaid cards as an entry point for helping unbanked consumers access transaction accounts and enter the financial mainstream. The ability to deposit funds other than government payments would be critical to such efforts. Yet banks over \$10 billion, with their wide ATM networks, would not be able to participate.

Drawing a line between prepaid cards and bank accounts is not an easy task. Regulators have reason to fear that laws will be evaded if it is too easy to move back and forth across that line.

¹⁶¹ 15 U.S.C. § 1693o-2(a)(7)(B)(i), (ii); see Reg. II, 12 C.F.R. § 235.5(d)(1), (2).

¹⁶² 12 C.F.R. § 235.5(b); Official Board Commentary on Reg. II, 12 C.F.R. § 235.5, Comment (5)(b)-1.

But getting the line right is essential. The FRB and CFPB should work together to define the essence of a prepaid card in a manner that protects prepaid card users and does not undermine the rules governing bank accounts. We believe that the “qualified prepaid card” definition that we have proposed achieves this purpose.

4. College, Health and Other Special Purpose Cards Should Be Covered by Regulation E

GPR cards used for a specialized use, such as college and health spending cards, should also be covered under Regulation E. All of these cards are subject to fraud or errors just like any other GPR card. Consumers have the same need for error resolution and protection from unauthorized use. These cards are used over an extended period of time and can involve substantial sums of money, often several thousand dollars. Consumers need account information just as with other GPR cards, as well as fee disclosures and protection from unauthorized overdraft programs.

There is nothing in the specialized nature of these cards that dictates an exemption from Regulation E. Indeed, there may be even more need with health spending cards for the error resolution requirements, given how complicated health care billing has become with the intersection of insurance denials or partial payments, deductibles, co-payments and other bureaucratic complexities. Providers can accidentally double bill, or overcharge before an insurance payment comes in. A consumer should have the ability to invoke the error resolution process when she suspects a healthcare provider has billed the wrong amount, or the card issuer has erroneously processed a transaction. Moreover, many if not most university and health spending cards already comply with Regulation E.

The Bureau should also consider whether full Regulation E statement requirements should apply to health and other flexible spending programs. These accounts can be especially prone to errors that consumers may not realize, and paper statements may be a more appropriate default rule. Consumers are provided these cards without requesting them,¹⁶³ may not use them or do so rarely, may not be monitoring their accounts, and may not suspect that the card has even been used without their authorization. Yet the cards are Visa or MasterCard branded and are subject to fraud and authorized charges like other prepaid cards (even if they are not so broadly useable). The CFPB should consider whether paper periodic statements are important to give a consumer proactive notice about transfers from these account unless the consumer has opted in to electronic statements following the E-Sign Act requirements.

5. Regulation E Should Cover Prepaid Cards Used for Needs-Tested Benefits

¹⁶³ At NCLC, for example, every employee who has signed up for a flexible spending account receives the prepaid card. Yet in light of the uncertainty about what payment is due for a doctor before insurance has been processed, and overlapping spousal benefit programs, some employees may not use the cards at all and instead submit claims manually.

a. Overview

The EFTA exempts “electronic benefit transfer” (EBT) systems through which government agencies establish accounts to distribute needs-tested benefits.¹⁶⁴ That exemption was created for government agencies in 1996 in conjunction with a mandate for states to switch from paper-based to electronic systems of paying benefits. States, unfamiliar with Regulation E compliance and without the banks’ infrastructure, were concerned about the costs of being subject to the EFTA’s liability provisions. The exemption is found in a section of the EFTA dealing with the EFTA’s applicability to providers, like government agencies, *other than* financial institutions.

States are now beginning to migrate their cash needs-tested benefits, like Temporary Assistance to Needy Families (TANF), from the older EBT system to the newer prepaid card platform. As they do, neither the language of the EFTA nor the policy behind the EBT exemption supports a Regulation E exemption for the financial institutions that issue prepaid cards used to deliver cash-based means-tested benefits.¹⁶⁵

In short, as described in detail below:

- The EBT exemption covers a system under which “a government agency distributes needs-tested benefits by establishing accounts” Prepaid cards differ from EBT cards in that they involve accounts created by and in the name of the prepaid card program manager, not government agencies, and the financial institution distributes the funds, not the agency.
- Prepaid cards today routinely comply with the EFTA (or at least represent that they do), even on cards holding needs-tested benefits. They do not need the EBT exemption.
- Prepaid cards are more widely usable than EBT cards and are more subject to loss, theft and unauthorized transfers, like all Visa or MasterCard branded cards. Poverty-level recipients of needs-tested benefits need the EFTA’s protections even more than other consumers. EBT cards have substandard protections.

Prepaid cards used to deliver needs-tested benefits should be treated no differently than cards that deliver non-needs-tested government benefits (like unemployment benefits) and federal need-tested benefits, both of which are already covered by the EFTA and Regulation E.

b. The EBT Exemption is an Exemption for State and Local Government Agencies, Not for Financial Institutions

¹⁶⁴ 15 U.S.C. § 1693b(d)(2).

¹⁶⁵ There is a separate statutory exemption for Supplemental Nutrition Assistance Program (SNAP) benefits (food stamps). 7 U.S.C. § 2016(h)(10). States are also unlikely to use the prepaid card platform for other noncash benefits, and if they do, the program restrictions might present different issues for Regulation E applicability. These comments do not address whether or how all or parts of Regulation E should apply to noncash benefits.

In 1974, the only type of consumer-related account that Congress imagined, and the only type covered by the EFTA, was the consumer's own account at a financial institution. However, by the early 1990s, states and localities were beginning to develop EBT systems that did not involve an account in the name of the consumer.

In 1994, the Federal Reserve amended Regulation E to declare that EBT systems were within the scope of the EFTA, to be effective in 1997. At about the same time, Congress was developing legislation that would require states to move from costly paper-based systems of government transfer payments to more efficient electronic transfer systems.

State and local governments, which did not have the experience that banks did with Regulation E, reacted with consternation. Although the move from paper-based payments to electronic payments was expected to save money, state and local governments expressed dismay at the potential costs of complying with Regulation E's liability provisions and of protecting consumers from lost or stolen funds or unauthorized charges.

Congresswoman Marge Roukema summarized the concerns at a 1996 hearing on the issue:

Several States have indicated that the liability provision of Reg E would subject States to indefinite liability and jeopardize EBT development because of the increased costs for the States in complying with the liability of Reg E. . . . Some local governments have stated that the expense involved in complying with the liability provisions may cause them either to not implement EBT or to terminate the current EBT system. That is the heart of this controversy.¹⁶⁶

One state commissioner testified:

Reg E mandates that the entity issuing cards, in this case, States and localities, but typically banks and other financial institutions, must replace all but \$50 of lost or stolen funds. This decision radically changes significantly current social service benefits policy by creating a new entitlement to lost or stolen benefits. . . . The preliminary results from the first several months of pilot tests of implementing Reg E in two States, including ours, also show that this expense—*not so far that we have seen on the benefit replacement side but the investigatory administrative side—in the fair hearing cost side has been very high. . . .* Many States have decided to delay EBT implementation or have not gained approval to move forward with their contract until it is clear that Congress and the President will approve an exception.¹⁶⁷

¹⁶⁶ Opening Statement of Rep. Marge Roukema, "Electronic Benefit Transfer Systems And Regulation E," Hrg. of the House of Rep., Subcomm. on Fin'l Inst's and Consumer Credit, Comm. on Banking and Fin'l Svcs. (June 19, 1996) ("House EBT Hrg.").

¹⁶⁷ Statement of William Waldman, Commissioner, NJ Dep't of Human Svcs., Representing the American Public Welfare Association, House EBT Hrg. (emphasis added). States may have felt compelled by the Due Process

A state comptroller emphasized the distinction between subjecting states and banks to the EFTA:

Many participants in EBT systems development, most notably the States, hold the position that Regulation E, *crafted for the private sector in 1976*, is inappropriate to government EBT in 1996.¹⁶⁸

Ultimately, Congress passed a bill requiring states to provide food stamps by electronic delivery and encouraging states to develop electronic systems to deliver other types of benefits as well.¹⁶⁹ The bill also exempted EBT systems from the EFTA.¹⁷⁰ In addition to the EBT exemption within the EFTA, a parallel exemption was added to the Food Stamp Act.¹⁷¹ The Food Stamp Act contains its own provisions governing lost or stolen cards, error resolution and account records.¹⁷² There is no federal exemption outside of the EFTA for other types of needs-based benefits, such as Temporary Aid to Needy Families (TANF, which replaced AFDC).

As illustrated above, the exemption was crafted for state and local governments and was designed to address their particular needs. The exemption was not aimed at banks, which were already covered by the EFTA and had a well-developed infrastructure for handling errors, loss and theft and unauthorized charges.

The EBT exemption does not cover needs-based benefits distributed by the federal government.¹⁷³ For example, Supplemental Security Income, a needs-based disability and income security program distributed in part through the Direct Express® prepaid card, is covered by the EFTA and Regulation E. Thus, there is nothing inherent in needs-based benefits that demands an exemption from the EFTA.

c. EBT Card Systems and Prepaid Card Systems Have Important Differences

Although the term EBT often refers to the legal definition in the EFTA (and the needs-based benefits covered by that definition), the term has a second, more technological definition. The term “EBT card” often is used to refer to the specific form of card and of technology currently

Clause to conduct fair hearings, which banks, who are not subject to the Fourteenth Amendment, do not provide when resolving liability issues under Regulation E.

¹⁶⁸ Statement of William Kilmartin, Comptroller, State of Massachusetts, House EBT Hrg. (emphasis added).

¹⁶⁹ See Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 110 Stat. 2105 (1996); see generally National Consumer Law Center, Consumer Banking and Payments Law § 8.1.1 (4th ed. 2009 and Supp.).

¹⁷⁰ 15 U.S.C. § 1693b(d)(2).

¹⁷¹ 7 U.S.C. § 2016(h)(10).

¹⁷² See National Consumer Law Center, Consumer Banking and Payments Law § 8.7, 8.8 (9th ed. 2009 and Supp.).

¹⁷³ The EBT exemption applies to a system “established under State or local law or administered by a State or local government.” 15 U.S.C. § 1693b(d)(2)(B).

used to deliver most needs-tested benefits. EBT cards and EBT payment systems differ in many ways from the newer prepaid card platform developed several years later.¹⁷⁴

i. EBT Cards

Under an EBT system, a bank account is established by a government agency and is held in that agency's name. The agency deposits benefits into that account, but the funds remain in the hands of the agency until the funds are spent. Until then, the government agency retains control over the funds, earns any interest generated, determines whether the funds allocated to a particular recipient expire if unused, and keeps those funds if they do expire.

The government agency or the bank produces an EBT card that is issued to the benefit recipient to access the funds. When a recipient uses an EBT card, funds are transferred through the automated clearinghouse ("ACH"), typically under the Quest Operating Rules. That is, at the end of the day, the funds to cover all of the day's transactions are transferred from the government to the merchant (or to a bank, if the funds are accessed through an ATM) over the ACH system. Technologically, the transfer is no different from any other form of ACH transfer, such as an electronic bill payment from a consumer's account to pay a bill.

Similarly, if the benefits recipient loses the card, the card is stolen, or there are unauthorized charges, the recipient must generally resolve the problem and seek any reimbursement from the government agency. It is up to the government agency to decide whether or under what circumstances the consumer will be reimbursed. The process for doing this and the rights recipients have in recovering unauthorized withdrawals vary by state. The government agency covers any losses that the recipient does not bear.

EBT cards do not carry any "zero liability" coverage. The bank where the funds are held does not cover any liability for lost funds.

EBT cards are accepted only at limited locations, generally those that subscribe to the Quest rules or another network. The transactions travel over a different payment rail than credit or debit cards. That is why, at a supermarket for example, the consumer has the choice of selecting "EBT," separate from "credit" or "debit," at the register. Traditionally, only markets, check cashers and ATM machines have accepted EBT cards, but some pharmacies, clothing stores, salons and other locations now accept them. The cards typically carry the Quest logo or another EBT network logo, not a Visa or MasterCard logo, and are not accepted on nearly the same widespread basis.

¹⁷⁴ The following description is based on our understanding following several conversations with various experts. We believe it is accurate but would appreciate hearing about any inaccuracies.

Currently, EBT cards can only be used in person and require entry of a personal identification number (PIN). They cannot be used over the internet and do not carry bill-pay features, though it is possible that this capability may be added in the future.

ii. Prepaid Cards

Prepaid cards operate on a different system than EBT cards. With a prepaid card, the government agency transfers the funds in a lump sum on a periodic schedule to the bank that issues the prepaid card. For example, if benefits are paid biweekly, then every two weeks the agency will transfer to the bank all of the benefits for the recipients entitled to payments.

The funds are held in a pooled account in the name of the prepaid card program manager, not the government agency, with subaccounts for the individual recipients. The government agency does not control the account nor the distribution of the funds to recipients. After a purchase is made, the funds are transferred from the pooled account to the merchant (or to a bank, if funds are accessed through an ATM) over the ACH system.

The bank controls the funds and keeps any accrued interest and may collect inactivity fees if the recipient does not use the funds. Unused fund may not return to the benefits agency, though eventually they could escheat to the state if they have not been consumed by inactivity fees.

Only the bank, not the government agency, produces prepaid cards issued to the benefits recipient. Prepaid cards carry the brand of a network association, typically Visa or MasterCard, and funds are distributed across the applicable network. The cards are accepted anywhere Visa or MasterCard debit cards are accepted. They are covered by the Visa or MasterCard zero liability policies. Prepaid cards can be used for signature based transactions but still require a personal identification number for ATM withdrawals and locations that do not accept credit cards.

On a prepaid card, the bank is responsible for resolving and assuming liability for loss, theft, error or unauthorized charges (subject of course to timely reporting by the consumer and absence of fraud). The government agency bears no responsibility for reimbursing the consumer for lost funds.

Virtually all government prepaid card programs follow Regulation E rules and regulations. Vendors who have been talking to states about switching from EBT cards to prepaid cards have been representing that the cards are fully Regulation E (payroll card rule) compliant.

Most benefits deposited onto prepaid cards are cash benefits with minimal or no restriction on their use. EBT cards, on the other hand, are often restricted to particular food items.

Prepaid cards deliver so much revenue for banks that they typically offer to administer government benefits programs at no cost to state governments, and even on occasion to share

that revenue with the state. Revenue comes from two primary sources: interchange fees on merchants and fees imposed on consumers.

Prepaid cards can come with a variety of fees, including ATM fees (in addition to surcharges), balance inquiry fees, inactivity fees, and sometimes PIN debit, denied transaction, teller withdrawal and other fees that are not typically charged on EBT cards.

d. The EBT Exemption Does Not and Should Not Cover Prepaid Cards Issued by Banks

The EBT exemption is found in the Regulations section of the EFTA:

§ 1693b. Regulations

(a) Prescription by the Bureau and the Board

(1) In general. Except as provided in paragraph (2), the Bureau shall prescribe rules to carry out the purposes of this subchapter.

...

(d) Applicability [of the EFTA] to service providers other than certain financial institutions

(1) In general

If electronic fund transfer services are made available to consumers by a person *other than a financial institution holding a consumer's account*, the Bureau shall by regulation assure that the disclosures, protections, responsibilities, and remedies created by this subchapter are made applicable to such persons and services.

(2) State and local government electronic benefit transfer systems....¹⁷⁵

As the section heading and general provision of section (d) make clear, this section is aimed at the circumstances under which government agencies would be covered by the EFTA. Financial institutions were already covered.

This exemption is designed for EBT systems, which are systems “under which a government agency distributes needs-tested benefits by establishing accounts that may be accessed by recipients”¹⁷⁶ With prepaid cards, however, the government does not distribute the benefits

¹⁷⁵ 15 U.S.C. § 1693b (emphasis added).

¹⁷⁶ 15 U.S.C. § 1693b(d)(2)(A)(i).

or establish accounts. The bank that issues the prepaid card distributes the funds through an account and subaccounts that the bank or prepaid card program manager establishes.

In light of the legislative history of the EBT exemption and the differences between EBT and prepaid cards, the CFPB would be acting well within its statutory authority if it amended Regulation E to limit the EBT exemption to government agencies that issue EBT cards and not to banks that issue prepaid cards. Only EBT cards are systems “under which a government agency distributes needs-tested benefits by establishing accounts” Neither the rationale for nor language of the EBT exemption extends to prepaid cards.

It is consistent with both the policy behind the exemption and the statutory language of the EBT exemption for the CFPB to define EBT to cover only cards that operate on a EBT platform, a system under which the government agency itself directly manages the funds and handles loss and error resolution issues. This exemption would not extend to banks or program managers that operate cards on the prepaid card platform.

Even if the statutory language were not susceptible of this construction, the Bureau should use its exception authority to limit the scope of the EBT exemption. The EFTA provides that the CFPB may adopt “such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of electronic fund transfers or remittance transfers, as in the judgment of the Bureau are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.”¹⁷⁷

Coverage of prepaid cards that distribute needs-tested benefits is consistent with the purpose of the EFTA:

(b) Purposes. It is the purpose of this subchapter to provide a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund and remittance transfer systems. The primary objective of this subchapter, however, is the provision of individual consumer rights.¹⁷⁸

Protecting recipients of needs-tested benefits, who need the same rights as other users of prepaid cards, fulfills the purpose of the EFTA.

e. Extending Regulation E to Needs-Based Government Benefits Prepaid Cards Will Not Impose an Impediment to Adoption of Such Cards

Whatever cost concerns Regulation E posed in 1996 for state and local governments, those concerns are not an impediment today to extending Regulation E to prepaid cards issued by

¹⁷⁷ 15 U.S.C. § 1693b(c).

¹⁷⁸ 15 U.S.C. § 1693(b).

financial institutions for the purpose of paying needs-based benefits. Banks routinely comply voluntarily with Regulation E's payroll card rules for any prepaid card they issue, even though Regulation E does not presently apply to most prepaid cards.

Regulation E coverage for prepaid cards used to pay unemployment benefits has been no impediment to states' adoption of such cards.¹⁷⁹ Forty states and the District of Columbia use such cards.¹⁸⁰ There is no reason that needs-tested benefits should be treated any differently.

Even when they are distributing needs-based benefits, banks and program managers typically provide Regulation E protections on their prepaid cards. For example, Comerica Bank, which distributes the needs-tested Supplemental Security Income (SSI) payments through the Direct Express Card, provides Regulation E coverage by contract even though Regulation E does not directly apply.

Similarly, the Treasury Department's new rules mandating electronic payment of SSI require that *any* prepaid card that accepts the payments (whether the official Direct Express® card or a privately selected prepaid card) must provide Regulation E protections.¹⁸¹

Vendors who are soliciting state contracts to distribute needs-tested benefits, or discussing migration from the EBT platform to the prepaid card platform, represent that the prepaid cards will come with Regulation E protections. That is one of the benefits that states (and the advocates who advise them) are urged to consider.

Advocates and states rely on these representations in advising consumers who use needs-tested prepaid cards. In order for these representations not to be deceptive, it is essential that the cards be fully, legally protected by Regulation E and not merely the subject of vague voluntary assurances. Despite years of claims that all prepaid cards comply with Regulation E, we are hearing that those representations may not always have been true and that some programs are scrambling to comply with the new Treasury rules.

Financial institutions are eager to switch states from EBT cards to prepaid cards because prepaid cards generate more revenue for banks. Banks earn interchange fees on prepaid cards, which is a welcome trade-off for Regulation E obligations.

Banks that would be otherwise subject to interchange fee caps are exempt when they issue prepaid cards for government benefits, including needs-tested benefits. Compliance with

¹⁷⁹ The EFTA explicitly covers employment-related programs, including unemployment benefits. See 15 U.S.C. § 1693b(d)(2)(A)(ii).

¹⁸⁰ See NCLC Unemployment Compensation Prepaid Card Report. The District of Columbia adopted unemployment prepaid cards in December 2011. See <http://does.dc.gov/does/cwp/view,a.1232,q.644297.asp>.

¹⁸¹ The cost concerns may even have been overstated in 1996. Despite the fact that EFT-99 also mandated the federal government to switch from check-based to electronic payment systems, the EBT was only extended to state and local governments, not to needs-based federal benefit programs.

Regulation E should be a condition of that exemption. Interchange revenue can fund any losses from complying with the consumer liability and error resolution provisions.

The EFTA and Regulation E are familiar terrain for banks and program managers that issue prepaid cards. There is no need for an exemption when those cards are used for needs-tested benefits.

f. Recipients of Needs-Tested Benefits Paid on Prepaid Cards Need Regulation E Protection

Consumers who receive needs-tested benefits are, by definition, the neediest of all consumers. TANF is provided to households that have little or no income, and the median benefit is only \$428 a month or a paltry \$5,136 per year for a family of three. Benefits are *below* 50 percent of the poverty line in *all* states and are below 30 percent of the poverty line in the majority of states.¹⁸² Other state-based programs such as general assistance tend to have even lower eligibility levels and lower payments.

At these levels, even tiny fees have a big impact. To consumers living below the poverty line, every dollar is obviously critical. Every dollar that is lost, stolen or mistakenly taken out of that consumer's account is potentially a meal for the consumer and her family.

EBT cards do not come with the same protections that other cards receive under the EFTA. The SNAP regulations require only that the state assume liability for food stamp benefits taken after the recipient has reported the loss of the card.¹⁸³ Recipients are not protected against liability for losses before the theft is report nor for unauthorized charges taken through skimming without using the physical card. There are no federal requirements for the protections for TANF or for state-based benefits. For all of these needs-based programs, the protections from loss, theft, unauthorized charges and errors are up to the state. Many states do not have any statutes establishing the rights of these consumers.

Typically, many states protect recipients from liability only for funds lost *after* the card is reported lost or stolen or unauthorized charges are reported. That is, if the thief wipes out the entire account before the recipient realizes the card is missing, the recipient can lose the entire amount in the account.

A legal services attorney in New York described the problem one recipient had:

In 2008 I represented a client whose benefits were being removed from his EBT card by unknown person(s). Someone who had knowledge of his personal information and card #

¹⁸² See Ife Finch and Liz Schott, Center on Budget and Policy Priorities, "TANF Benefits Fell Further in 2011 and Are Worth Much Less Than in 1996 in Most States" (Nov. 21, 2011), available at <http://www.cbpp.org/cms/?fa=view&id=3625>.

¹⁸³ 7 C.F.R. § 274.12(f)(5)(iv).

was able to go into the EBT system and change his PIN and access his pa/fs benefits without using the physical card, apparently by going to store(s) and keying in the card number and PIN. The client requested replacement benefits but was denied, and lost a hearing. We appealed in state court. The case was settled and his lost benefits were restored, but the State's position is that benefits taken from EBT accounts cannot be replaced until and unless the client reports the first occurrence and the welfare agency does not act to fix the situation as by putting a PIN lock on the account. If the agency doesn't act to protect the benefits after the initial report, subsequent losses can be restored, but still not the loss from the initial theft.

Recently, I saw that Unemployment Insurance Benefits recipients in NY State, victimized by identity theft, were getting stolen benefits replaced. I asked a NY state welfare agency official why that happened for UIB recipients but not EBT users. His response was that UIB recipients have Regulation E protection, EBT users do not.¹⁸⁴

A newspaper article described the hardship that an 81-year old Food Stamp recipient, sick and mourning the passing of his wife, faced when his card was compromised and benefits were stolen:

Food stamps and Supplemental Security Income barely cover Mr. Fishman's monthly expenses. When the thieves cleared out his monthly food stamp allowance of \$162 - by duping Mr. Fishman's son into giving him the account information over the phone - he was left to rely on others for food.

The next month, the thieves struck again....

Last summer, someone called Mr. Fishman's house, and said he had to confirm information about the benefit card Mr. Fishman used for food stamps. Mr. Fishman handed the phone to his son, Aleksander.

He thought it odd that the man was calling in the evening, but he and his son soon forgot about the call - until the day Mr. Fishman tried to use his food stamp card. He contacted the police, but somehow the thieves were able to clear out the account a second time.

When he read an article about food stamp theft in a Russian-American Jewish newspaper, Mr. Fishman contacted the Edith and Carl Marks Jewish Community House of Bensonhurst, a beneficiary agency of UJA-Federation of New York, one of the seven

¹⁸⁴ Email from Marianne Joyce, Legal Services of New York City-Bronx to Lauren Saunders (Feb. 25, 2010) (on file with NCLC).

agencies supported by The New York Times Neediest Cases Fund. At the community house, he was given a cash grant of \$100 from the fund (and a hot lunch).¹⁸⁵

While the substandard protections on EBT cards are already problematic, more robust protections against unauthorized charges are especially essential as needs-based programs move to prepaid cards:

- Prepaid cards are much more widely accepted – anywhere that accepts a Visa or MasterCard debit card – compared to EBT cards, which are typically only accepted at grocery stores and pharmacies. They will be used at more locations where they can be subject to identity theft and are more attractive targets.
- Prepaid cards are easily used without the physical card, such as over the internet or telephone. Thus, the card can be the subject of unauthorized charges without the consumer even knowing that the card has been compromised. The state liability rules that apply to EBT cards are totally inadequate to protect users of network branded prepaid cards.
- Prepaid cards are functionally no different from debit or credit cards and are subject to the same scammers who steal identities from other Visa or MasterCard users. EBT are less a target of scammers.
- EBT cards require use of a personal identification number (PIN), whereas prepaid cards do not. Fraud is more common and easier to perpetrate with signature-based purchases.
- Without Regulation E protections, states are less likely to take up the prepaid card option. Some contractors are promising protections to states and rules must ensure that the promise is real.

Consumers who use prepaid cards need full Regulation E protection even if, or especially if, their cards are loaded with needs-tested benefits. The CFPB should provide that protection as part of the upcoming GPR rulemaking.

6. Mobile Payment Systems are Prepaid Cards

Mobile payment systems that function as virtual prepaid cards should also be covered by Regulation E. Consumers need the same protection for electronic transactions made through a mobile payment system that is reloadable and usable for general purposes as they do for a physical prepaid card. Broad coverage of the entire market will prevent evasions. The CFPB should not issue a rule that is outdated and overly narrow before it even goes into effect.

¹⁸⁵ Kareem Fahim, “The Neediest Cases: Mourning and Ailing, Then Robbed, Twice” (January 24, 2009), available at <http://www.nytimes.com/2009/01/24/nyregion/24neediest.html>.

Regulation E's definition of "financial institution" already includes any person that issues an "access device" and agrees to provide electronic fund transfers.¹⁸⁶ "Access device" in turn includes "a card, code, or other means of access to a consumer's account,"¹⁸⁷ a definition that should take into account virtual prepaid cards accessed through mobile devices. On the other hand, the definition of "electronic fund transfer" has an outdated list of the locations at which electronic transfers can be initiated and should be updated to make clear that it includes transfers initiated through a smart phone or text message.¹⁸⁸

The CFPB should also clarify that the Regulation E exclusion for telephone-initiated transfers¹⁸⁹ applies only to transfers initiated through a live conversation with a person and not a transfer through a computerized process that just happens to use a telephone.¹⁹⁰ Telephone transfers were excluded only because Congress felt that the involvement of a human being made the EFTA's protections and procedures unnecessary. Thus, IVR transfers, transfers initiated by text message, and smart phone payment systems should all be covered by Regulation E.

B. Regulation E Modifications

The full Regulation E protections, including paper statements and dispute rights triggered by those statements, are important. The lower income consumers who use prepaid card are less likely to have either the equipment or comfort level to access statements electronically. To the extent that any modifications are permitted, on qualified prepaid cards should be entitled to modified requirements. Moreover, modifications must improve upon the payroll card rule, which is inadequate to ensure that consumers have access to critical account information.

1. Only Cards That Meet Certain Qualifications Should Be Entitled to Any Modified Protections Regarding Statements; Bank Accounts Should Not Be Permitted to Exploit these Modifications

If any modifications are permitted, prepaid cards should be eligible for those modifications only if they meet certain conditions. The CFPB should also take care to define "prepaid card" so that it does not inadvertently modify or eliminate the statement requirement for bank accounts or create a loophole that can be exploited for that purpose.

First, prepaid cards should be exempt from paper statement requirements only if they have no overdraft fees or credit features. As discussed above, a clear ban on overdraft fees and credit

¹⁸⁶ 12 C.F.R. § 1005.2(i).

¹⁸⁷ 12 C.F.R. § 1005.2(a)(1).

¹⁸⁸ 12 C.F.R. § 1005.3(b)(1). The definition does include debit card transactions but Regulation E does not define "debit card." The definition also includes transfers initiated by "telephone," but then takes some of those transfers away in a subsequent section.

¹⁸⁹ 12 C.F.R. § 1005.3(c)(6).

¹⁹⁰ See Mark E. Budnitz, *Mobile Financial Services: The Need for a Comprehensive Consumer Protection Law*, 27 *Banking & Finance L. Rev.* 213 (2012).

features is far preferable and will prevent evasions and an uneven playing field.¹⁹¹ But at a bare minimum, any cards that pose the risk of triggering overdraft fees or putting the consumer into debt with an obligation to repay that debt should be subject to full statement requirements – both under Regulation E, and also under the Truth in Lending Act and Regulation Z.

Statements are an important right under Regulation E. They help consumers monitor funds that go into and out of their accounts, keep watch out for unauthorized charges and errors, and see the fees that they are being charged.

The alternatives to automatic paper statements, discussed below, are imperfect. Most consumers are likely to see their account balance and little else. The statement alternatives should not be permitted for cards that have overdraft fees or credit features (unless the consumer has opted for electronic statements following the requirements of the E-Sign Act).

Overdraft fees are an extremely expensive form of credit and consumers need to be aware how much they are overdrafting. Statements help consumers realize that they are paying overdraft fees and to see how many fees they are paying throughout the year. Consumers who have not affirmatively elected electronic statements may never log on to see their accounts and may have no idea how much they are paying.

Statements are essential to budgeting. Statements can help consumers to see the course of their expenses and transactions throughout the month and to understand how they came up short at the end – whether they ended up triggering overdraft fees or using a credit product.

Consumers who end up with a negative or credit balance will also have an obligation to pay that balance, and statements help remind consumers about that debt and to plan for how they satisfy that debt on top of their regular expenses. Research has shown that consumers are less likely to elect electronic statements for credit cards – where there is a payment due – than they are for bank accounts, for which statements do not demand any action.¹⁹² That is, consumers are deliberately choosing to retain paper where they need a reminder or clear notice.

Withholding modification of Regulation E's statement requirements does not mean that every prepaid card with credit features will be required to mail out paper statements. Electronic statements will be permitted if the consumer has opted for them over paper. However, as discussed below, the regular Regulation E and E-Sign Act requirements need to be bolstered in order to prevent evasions.

¹⁹¹ Consent under the E-Sign Act can be manipulated to achieve the same result as a modified requirements, with the result that the consumer does not truly see their statements and dispute rights expire before the consumer is even aware of an authorized charge or error.

¹⁹² Emmett Higdon, eBusiness & Channel Strategy Professionals, "Paperless Plight: Growing Resistance Outpaces Adoption Among US Bank Account Holders" at 2 (Nov. 1, 2010).

Second, prepaid cards should be entitled to modifications only if the funds are held in an account with deposit insurance, which protects the consumer from loss or a delay in accessing funds in event of insolvency of any party involved with the card. Here again, this requirement should apply to all prepaid cards. But at a minimum, consumers who might need to raise their claims in a prepaid card provider's bankruptcy proceeding should have full statement rights and a record of their funds and transactions.

Finding records from an insolvent issuer can be difficult if the issuer ceases operation and no longer maintains a website or an adequately staffed customer service line. Even years after bankruptcy proceedings are concluded, the consumer may find a need for records to show a history of income and expenses for use on a credit application, prove a payment was made, file tax returns, or contest a tax audit. The records might also be necessary to support a claim in the issuer's bankruptcy.

Third, any Regulation E modifications should apply only to prepaid cards, not to checking accounts or other individual bank accounts. The definition of what constitutes a prepaid card, and what accounts are entitled to modifications, should be drawn carefully so that bank accounts do not qualify. The longstanding existing EFTA requirement for written statements for bank accounts should not be eviscerated or subject to gaping loopholes.

Fourth, as discussed above, the CFPB should consider whether modification of the statement requirement is inappropriate for flexible spending accounts, where many consumers are less likely to monitor accounts online and may not notice unusual charges.

Thus, a qualified prepaid card account should be entitled to modified Regulation E requirements regarding statements only if:

- The card meets the basic definition of prepaid card and is not a bank account: the funds are held in an account other than one in the name of or for the benefit of the consumer at a depository institution (i.e., in a subaccount or in an account held by an entity other than a bank or credit union);
- The account has no credit features, including overdrafts, or the capacity to write checks or to make electronic transfers that are not immediately funded;
- The account is covered by depository insurance;
- The account can hold no more than \$10,000 (or a lower number, if appropriate).

The limit on the size of the account is necessary to ensure that bank accounts do not exploit this definition to escape full statement requirements. As checks become less and less important, banks may develop checkless checking accounts and could even hold them in subaccounts in order to fit within the definition of "prepaid card." While we believe that accounts of all sizes

should provide paper statements as the default method, modifications are only appropriate for prepaid card accounts that have thin profit margins and need statement relief in order to avoid excessive fees and be viable for lower income consumers.

2. Modifications Must Ensure that Consumers Have Ample Free and Convenient Access to Statements and Account Information, Beyond the Payroll Card Rules

a. Convenient Access to Statements Is Important

Regulation E requires that institutions provide written statements for important reasons. Written statements help consumers balance their accounts. They provide a permanent record of the consumer's income, expenses, transactions and fees. They enable the consumer to review the account for fees and unauthorized charges. Consumers can check statements to ensure that they received proper credit for an item returned or disputed. Statements are used for budgeting and for qualifying the consumer for a mortgage or other forms of credit. As consumers increasingly use debit cards (and switch from credit cards) for everyday transactions, statements are important when preparing tax returns and when looking for a record of a payment.

Ample free access to account information is important not only for everyday reasons. It also helps to deter unscrupulous practices. This example from a fee harvester credit card illustrates the issue:

I got this card 4 years ago to help build my credit. It seemed like a good idea at the time because I was desperate to get a lender that would trust me and build my credit. I read the offer in its entirety and didnt see anything about the numerous annual, monthly, usage and processing charges.

I received my card with a credit limit of \$250, but \$175 had already been racked up on the card for processing fees. I was upset, but disregarded and paid becuase I didnt have room to be picky. Every month I would look at my statement online and cringe at how much money this company was making off me....

I wanted to print out my statement for 2011 to find out how much interest and fees I paid. I am reworking my budget and am weeding out any unnecessary financial burdens. There was no way to print or even see my statements from more than 3 months ago. I pay an monthly internet access fee to be able to SEE a few months worth of data. I know they do this on purpose so we cannot go back and see exactly how much we have been ripped off.

I called in to the company to request a year-end statement. The representative told me that I would have to pay \$5 per monthly statement. If I wanted them for all of 2011, it would be \$60. I lost it and requested that they close my account immediately. The

representative asked me why and I told her that her company has made soooo much money off of me, its ridiculous. I pay a monthly fee for internet, a monthly fee for service, monthly interest, annual fees and that should be MORE than enough to be able to request my OWN personal statements.¹⁹³

Unfettered access to account information, which enables and encourages consumers to see the fees they are charged, is essential. While the CFPB is working to improve up front disclosures, even the best disclosures are only partially useful, and shady operators will obscure them. Both full Regulation E and any modified rules must ensure that consumers have ample free access to account information.

For traditional bank accounts, banks may dispense with paper statements only if the consumer chooses to opt in to electronic statements following the requirements of the E-Sign Act. That Act ensures that the consumer has the choice of method of account information that works best for that consumer, that the consumer has the ability to access electronic statements, and that the statements are provided in a form the consumer can keep as a record.¹⁹⁴ It ensures that a consumer who chooses electronic statements is on the proper side of the digital divide, with real, meaningful and full Internet access.

As the CFPB considers modifying paper statement requirements for prepaid cards, the following basic facts and principles be kept in mind:

- According the U.S. Census, over 30% of all adults do not have access to the Internet at home.
- Over 70% of older Americans (defined as 55 and over) do not have access either at home or work.
- About 65% of low income people in the U.S. (defined as living on income of less than \$50,000 a year) do not have access to the Internet either at home or work.¹⁹⁵

For consumers who do not have ready access to the Internet at home or work, conducting transactions electronically becomes quite a challenge. Imagine not being able to receive mail at home, having to find a place to be able to open it, read it, and obtain special permission to print it or keep it (as one has to at a public library).

¹⁹³ <http://www.ripoffreport.com/credit-debt-services/first-premier-bank/first-premier-bank-first-premi-0dc59.htm>
(last visited 7/18/12).

¹⁹⁴ For a longer discussion of the importance of the E-Sign Act, see NCLC, “COMMENTS to the Consumer Financial Protection Bureau regarding Streamlining Inherited Regulations, Docket No. CFPB -2011-0039 at 17-23 (June 4, 2012), available at http://www.nclc.org/images/pdf/rulemaking/cm_cfpb_reply_comments_4_june_2012.pdf.

¹⁹⁵ See US Census Bureau, “Internet Access and Usage: 2009,” available at <http://www.census.gov/compendia/statab/2011/tables/11s1156.pdf>.

The mere fact that a consumer has opened an account on the internet or on a mobile device does not mean that the consumer either has the ability to receive electronic communications or that those communications are the best way to reach the consumer. The transaction could have taken place at a kiosk in the store of the provider, or an older consumer may have been assisted by a caregiver.

b. Statement Survey of NCLC Employees

An informal survey of NCLC employees bolsters the importance of giving consumers the choice of paper statements at a minimal cost. Of the 35 employees who responded to a survey, 66% receive paper statements. Out of those, 9% said paper statements were not important and 17% said that they preferred paper but would be comfortable monitoring their accounts online. But 74% felt that paper statements were important.

At the same time, few were willing to pay to continue receiving paper statements. Fifteen were unwilling to pay anything to continue receiving paper statements (65%), five were willing to pay \$1 (22%) and three willing to pay \$2-\$3 (13%). Interestingly, 10 of the 18 respondents who said that paper statements were important to them were part of the group unwilling to pay to continue receiving paper statements (56%). That is, even a small fee would discourage these consumers from continuing to receive paper statements despite their discomfort at monitoring their accounts online.

When asked what they would do if they did not receive a paper statement, replies included:

- “I would not review them online as I don’t want my banking information to be online for privacy reasons.”
- “I get so much email—much of it junk—that it’s too easy to overlook email from my bank. Plus, when I go online, I need to enter passwords and click through multiple web pages to find my statement. When the paper statement comes in the mail, I can just open the envelope and skim it immediately. I never forget to read my paper statements. I often fail to read online account statements.”
- “I pay many of my bills online but I still strongly prefer a paper monthly statement from my bank account. Computers can malfunction and I want a paper backup, which I keep in a fireproof box until I no longer need that information for tax purposes.”
- “I would (and do) review online statements less often than paper. With so many different accounts and passwords nowadays, it is easy to forget the password/username for each specific account, especially if you only use it infrequently (say, just to review a monthly or quarterly statement). And it can be a pain and hassle to find records or to go to where you keep a note of this information. It’s just not as easy as pulling out a hardcopy file

with hardcopy statements anytime you want. While electronic access allows for mobility, I usually check my finances at home, anyway, rather than on the road or out of the house. If I'm out of the house, I'm not doing finances but am engaged in other activities (i.e., the reasons why I'm out to begin with). I tend to my finances at home.”

- “I do not have time to review personal accounts at work and at home I am competing for the computer with my kids who need to do their homework and my husband who needs the computer. When my paper statement arrives in the mail, it takes me seconds to rip it open and glance through it for unusual charges. Without the prompting of that piece of mail, I would not remember to do it regularly online. The email reminder will only get buried in the hundreds of email solicitations I get every month from my bank and others. I am also really worried that I would overlook an important notice if it came only in email.”

Notably, this is a highly educated group that uses computers every day, works at an organization focused on consumer protection and vigilant against bank fees and scams, and where nearly every respondent has higher income levels than the typical prepaid card user. This finding confirms what we fear: that posing impediments for consumers to access transaction information in the form they are comfortable with could result in their not monitoring that information at all.

c. Recommended Modifications

For non-needs-tested government cards and payroll cards, Regulation E dispenses with the statement requirement on certain conditions.¹⁹⁶ Those conditions must be clarified and improved in order to ensure that consumers are protected.

First, consumers must have **ample free access to account balances**. As a condition of relief from automatic statement requirements, the CFPB should require that balance information be available in certain forms. Thus, the CFPB should require that balance information be provided, for free, through:

- ATM balance inquiries;
- Interactive voice response (IVR) automated toll-free telephone calls; and
- Text messages.

The first two requirements are consistent with the existing government benefit rule, which requires access through “a readily available telephone line and at a terminal.”¹⁹⁷ However, the CFPB should clarify that this requirement means that access must be free. NCLC’s survey of

¹⁹⁶ See 12 C.F.R. §§ 1005.15(c), 1005.18(b).

¹⁹⁷ 12 C.F.R. sec. 1005.15(c)(1); *see also* 12 C.F.R. sec. 1005.18(b)(i) (payroll card rule requiring access through a telephone line).

unemployment prepaid cards found that some charged up to \$1 for ATM balance inquiries even at network ATMs and up to \$0.50 for IVR inquiries.¹⁹⁸ Though these fees are small, even low fees can inhibit behavior, and consumers should never be inhibited from checking their balances through low cost channels. IVR access should also be through a toll free number.

The card provider should not charge for ATM balance inquiries even at out-of-network ATMs. The vast majority of consumers who use out-of-network ATMs will do so in order to withdraw cash, and a single fee for the cash withdrawal can cover any charge from the ATM provider to the card issuer, which is minimal in any event. Prohibiting a separate fee for the balance inquiry will simplify fee schedules, level the playing field, and ensure adequate access to essential information.

The CFPB should also **require that balance information be available for free through text messages.**¹⁹⁹ Text messaging is the simplest means of obtaining balance information. The consumer does not need to wade through a telephone menu, enter a long string of account numbers, or remember a password. She does not need to find an ATM, wait in line to use it, or waste time doing so if it turns out that the account has insufficient funds for a withdrawal. Text messaging is inexpensive for the provider and has become ubiquitous. If some prepaid card providers do not already offer text messaging, they should be given time to add that capacity but then be required to do so. Whether text messaging is required or merely optional, balance information should be free.

Second, consumers must have ample free access to statements and transaction information, and the right to **choose the form** in which they want to receive that information. Ensuring that consumers are comfortable monitoring their accounts, and actually do so, is extremely important. It would be highly dangerous to oversimplify the Regulation E requirements, and just to assume that consumers will monitor their accounts online. Issuers should be entitled to modification of the statement requirements only if they provide:

- **Free online access to transaction history.** It should be obvious that if a prepaid card provider is not providing regular paper statements – or even if it is – it should provide statements and transaction history online for free. That should be the interpretation of the current payroll card rule, but it should be made explicit to prevent fees by unscrupulous companies who wish to hinder access to account information. Fees should also be prohibited for access through mobile apps or other new platforms.

¹⁹⁸ NCLC, “Unemployment Compensation Prepaid Cards: States Can Deal Workers a Winning Hand by Discarding Junk Fees” Appendix C at 30-31 (May 2011) (NCLC Unemployment Prepaid Card Report), available at <http://www.nclc.org/issues/unemployment-compensation-prepaid-cards.html>.

¹⁹⁹ Of course, the consumer’s cell phone plan will determine whether the cell phone provider charges for the text message.

- **Online transaction information must cover at least the previous 24 months.** The 60 days provided in the payroll card rule is insufficient. Consumers who do not get statements and are reviewing their budgets for the previous year, looking for a charge several months ago, or doing their tax returns, need to have access to two years' worth of statements.
- **Free emailed statements, with actual transaction information in the email.** Emails alerting consumers that statements are available are helpful, but they require the additional step of going to a website, remembering a password and logging on. A summary of recent transactions in the email – for those who have opted in – is much more convenient and likely to be viewed.²⁰⁰
- **The right to request statements back several years.** Consumers who are relying on the issuer to store transaction information need to be assured that it is available as far back as they could conceivably want to go. Electronic storage is inexpensive. Tax returns can be audited for up to 7 years, debt collectors can come after consumers for decades, and consumers need to know that the records are there. The statements must also be free, whether the consumer requests one statement or several years' worth.
- **Notice of the availability and right to request an annual statement.** Some consumers may not be interested in monthly statements, or might feel comfortable going online occasionally, but will want statements for their records. A single annual statement may suffice and be less expensive to provide than monthly statements. Annual statements will also enable consumers to see totals of the fees they have been charged, prevent deceptive practices, and give consumers a better overview of whether the card is appropriate for them.
- **No fees for ad hoc requests for statements or annual statements.** The government benefit and payroll card rules give consumers the right to a written history provided promptly in response to a request.²⁰¹ Yet many prepaid card issuers (who purport to comply with those rules) charge fees as high as \$5.95 for statements when requested.²⁰² Such fees likely would violate current rules, but Regulation E should be clarified to make clear the statements are free. Consumers should not be charged for occasional statements if they are not receiving them automatically.
- **The right to sign up for automatic monthly paper statements for a minimal fee no more than the cost of the statement, approximately \$1 per month.** Some prepaid card issuers charge fees as high as \$5.95 even for an occasional account statement, and some

²⁰⁰ It might be prudent to omit full account numbers from such emails.

²⁰¹ 12 C.F.R. § 1005.15(c)(2), 1005.18(b)(1)(iii).

²⁰² See Consumers Union, "Prepaid debit cards booming, but beware," Consumer Reports (Mar. 29, 2012), available at <http://news.consumerreports.org/money/2012/03/prepaid-debit-cards-booming-but-beware.html>.

do not provide the option of regular statements at all,²⁰³ requiring the consumer to call in every month. Consumers who prefer paper statements should be able to get them for a nominal fee, no more than necessary to cover the cost of printing and mailing the statement. Fees should not be used to discourage consumers from accessing account information. Fees on account information are an inappropriate place to pad profit margins. Few consumers will actually opt in to paper statements, so the cost will be minimal, but if prepaid cards are to function as a trusted bank account alternative, this option must be available. The cost of printing and mailing a paper statement is less than \$1, and that fee should be more than enough to cover those costs. To the extent that there are any security concerns about mailing paper statements, the CFPB should consider whether the rules should be clarified to permit issuers to truncate account numbers on statements.

Third, consumers need to be able to contact customer service when necessary for free.

Customer service calls should be free. At a minimum, there should be no charge for calls to discuss a problem or resolve a dispute, IVR calls should be free, consumers should have a reasonable number of additional free calls, any fees should be waived for consumers with disabilities, and the consumer should be advised of the fee at the outset of the call and have the option of hanging up.

Prepaid cards are typically sold or provided in a setting where there is no brick-and-mortar access to a human being for questions. Consumers who are not getting regular statements and may not be familiar with transaction accounts should not be impeded from getting information that they need to understand their account and resolve issues.

Though providing customer service costs money, it is part of the overhead of managing a card program. The issuer will have incentives to develop convenient methods of providing information to avoid the need for telephone calls.

As older consumers leave the market, the newer generation that is more comfortable with other means of communication is likely to make less use of live telephone calls. But access to customer service is important for older consumers and those with disabilities. Customer service calls can also be avoided by being clear and honest up front about a product with no hidden surprises.

It should also go without saying that customer service should be provided through a toll free number. This is the standard in the industry, but in other settings, it appears that access to

²⁰³ See NCLC Unemployment Prepaid Card Report at 3, 30-31 (about 19 of 40 states surveyed did not appear to offer the option of monthly statements at any price).

customer service may have been inhibited through requiring the consumer to call a 900 number.²⁰⁴

Fourth, the time to dispute an item in the past year should begin running only when the consumer receives information that reveals the disputed item. It is unfair to expect consumers to dispute items that they have not seen if account information is not being provided automatically. Prepaid card providers should have an incentive to ensure that the consumer sees that information, to develop easy and useful communication methods, and to encourage the consumer to access transaction information. Providers could give consumers a range of options and require them to pick the one that suits them. Thus, consumers should have a full year to dispute items on their accounts²⁰⁵ unless the consumer has been provided a paper statement, has accessed the transaction history online or through a mobile app, or has received specific information about the disputed item in some other form. (For example, if the consumer has signed up for text message notification of transactions and has gotten a message about a particular transaction, the time would begin running once the statement that reveals that transaction has been made available.)

3. To Prevent Evasions of the Conditions on Modified Rules, The CFPB Should Clarify Regular Existing EFTA Statement and E-Sign Act Requirements

If the requirements discussed above apply only if a prepaid card issuer declines to follow Regulation E's regular statement requirements, then some issuers who wish to discourage access to information – or to charge inappropriate fees – may find ways to avoid them. One way to evade requirements for a qualified prepaid card is to induce the consumer to opt in to electronic statements under the E-Sign Act. Though electronic statements are permissible if the requirements of that Act are followed, the CFPB should clarify the rules to prevent evasions.

First, the CFPB should make the rules discussed above in Section III.B.2 apply to all accounts under the EFTA in addition to the regular statement requirements. For example, fees for access to balances, electronic transaction information, and customer service to resolve disputes are inappropriate on any account, and consumers should have the right to obtain prior statements for free on occasion on request even if they have opted in to electronic statements.

Second, the CFPB should clarify that the existing **Regulation E and Regulation Z statement requirements forbids fees for statements, whether paper or electronic.** Fees should not be

²⁰⁴ See <http://www.ripoffreport.com/credit-card-fraud/first-premier-bank/first-premier-bank-kept-incre-9d0b7.htm> (“I was offered to open a credit card with first premier for \$75.00. I sent them the \$95.00 to open the account. On janauary 31,2012 I received another bill for \$65.00 to access my account. I then told them to close my account because they kept increacing the amount of money to keep the account. I was then told I would have to contact a 900 number in order to clear up this mes.”). Using a 900 number for any customer service issue should be held to be an unfair practice.

²⁰⁵ One year is consistent with the EFTA's statute of limitations. 15 U.S.C. 1693m(g).

permitted for information that a bank is legally required to provide. Yet some banks are coercing consumers into opting in to electronic statements by making the cost of paper statements prohibitive. Banks should be permitted to offer a discount from a monthly fee for those who elect electronic statements over paper, but the discount should be no more than the cost to print and mail the statements, about \$1 per month. Any greater fee is actively discouraging consumers from getting essential account information in the form that they prefer.

For example, Bank of America's basic checking account – which is called “e-banking” – charges \$8.95 per month if the consumer elects paper statements.²⁰⁶ The bank's other accounts require direct deposit or high monthly minimum balances. The bank is free to set the price for its accounts, and \$8.95 may not be an unreasonable fee for a checking account. But the fee structure should not be used to push consumers into signing up for electronic statements – and evading the legal requirement to offer statements – if the consumer is unable to or unlikely to use them.

Fees should not impose obstacles to financially responsible behavior. Getting into the habit of reviewing an account regularly is hard enough. The result of coercive measures to eliminate paper statements will be that some consumers will not review their transaction information at all. A \$1 discount that merely recoups the cost of printing and mailing the statements strikes the balance between ensuring access to statements in the form the consumer prefers while providing an incentive to use more cost efficient means when workable.

Conversely, others – like First Premier Bank – are actually charging for online access, as discussed above. No fee should be permitted at all for online account information. Such a fee is merely designed to discourage access to account information and to disguise the overall cost of the product.

Third, the CFPB and other regulators should enforce the existing E-Sign Act prohibition on requiring opt in to electronic statements. The essence of the E-Sign Act is that electronic information may substitute for legally required written information only if the consumer *chooses* an electronic format.²⁰⁷

²⁰⁶ In order to get the monthly fee waived, the consumer must opt into electronic statements and not make any deposits or withdrawals at a teller.

²⁰⁷ For a longer discussion about the importance of the E-Sign Act, see NCLC, “Comments to the Consumer Financial Protection Bureau regarding Streamlining Inherited Regulations, Docket No. CFPB -2011-0039” at 17-23 (June 4, 2012) (“NCLC Streamlining E-Sign Comments”), available at http://www.nclc.org/images/pdf/rulemaking/cm_cfpb_reply_comments_4_june_2012.pdf.

The statute is crystal clear. The consumer *cannot* be required to consent to electronic writings, must be informed of the availability of paper records, has the right to withdraw consent, and must be told the procedures for doing so.²⁰⁸

Yet some prepaid card credit products violate Regulation Z statement requirements and require the consumer to “opt in” to electronic statements as part of the application process.²⁰⁹ Providers in other contexts do as well.²¹⁰

If prepaid cards are able to violate the regular Regulation E statement requirements by ignoring the E-Sign Act rules, they will be able to evade the careful requirements the CFPB may develop for statement alternatives and modified Regulation E requirements.

This is especially important as some prepaid cards move into the virtual world through mobile payment systems. Some in industry have urged the CFPB to presume that the consumer has consented to electronic information if the consumer has accessed a product through the internet or a mobile device. Such a presumption is inappropriate. Merely because a consumer uses a mobile payment system does not mean that the consumer has regular internet access or is comfortable monitoring the account online or on a mobile device. Mobile devices also do not provide a record the consumer can keep. We discussed these issues in greater length in earlier comments.²¹¹

Finally, the CFPB and other regulators should examine banks and prepaid card providers to ensure that the other E-Sign Act requirements are followed. In addition to consent, E-Sign requires that the consumer demonstrate the ability to access electronic information and the information be provided in a form the consumer can keep. Yet we suspect that some companies are not following these requirements, and the record keeping requirement in particular may not be satisfied by mobile payment systems.

C. Regulation E Enhancements

1. Merchant Chargeback Rights

Prepaid cards, as well as bank account debit cards, should have the same chargeback rights against merchants that credit cards have under Regulation Z. Regulation E’s error resolution provision does not include disputes with merchants over problems associated with the purchase

²⁰⁸ See 15 U.S.C. § 7001(b)(2), (c); *see generally* National Consumer Law Center, Consumer Banking and Payments Law § 11.3.5.1 (4th ed. 2009 and Supp.).

²⁰⁹ SureCashXtra requires the consumer to opt in to electronic statements, evading the Regulation Z requirement.

²¹⁰ Bill Me Later, for example, requires the consumer to opt in to electronic statements. *See* <https://mysurecash.com/Apply.aspx> (last visited 7/23/12).

²¹¹ *See* NCLC Streamlining E-Sign Comments.

of goods and service, such as failure to deliver and defective quality. This discrepancy should be corrected.²¹²

The likelihood of a problem with a purchase is no different when the purchase is made with a credit card than when a debit or prepaid card is used. They are interchangeable as payment devices, both accepted universally. Consumers need the same ability to dispute a charge if they did not get what they paid for regardless of the type of card used.

When consumers see the Visa, MasterCard or American Express logo on a card, they expect a certain level of protection. They do not understand that their rights are fundamentally different depending on the type of card they use.

Uniform chargeback rights are necessary to avoid deception. The major networks and issuers all advertise “zero liability” policies and claim that those policies apply uniformly to all Visa, MasterCard, Discover or American Express cards, whether credit, debit, or prepaid. Yet there are limitations to these policies that consumers do not understand and the policies are not applied uniformly.

Consumers do not realize that these zero liability policies are not the same as full Regulation Z chargeback rights or that there are significant tricks in the policies. Zero liability protection does not apply if the consumer pushes “debit” and enters a PIN; the networks permit chargebacks only if “credit” is selected. Even when “credit” is selected, the networks reserve the right to deny protection in a variety of circumstances, such as if the network believes the consumer has not exercised reasonable care.²¹³ A study by the Philadelphia Federal Reserve also found that card issuers varied from one another in the way they implemented the zero liability policies.²¹⁴

The rules of the National Automated Clearinghouse Association (NACHA) provide some protection in case of disputes with merchants. The rules permit disputes, and a right of recredit, if the merchant did not comply with requirements for obtaining the consumer’s authorization, if the debit is greater than the amount authorized, or if the debit was initiated for settlement earlier than the consumer authorized.²¹⁵ However, consumers get no notice of these rights, are completely unaware of them, and may not have the ability to enforce them.

Uniform chargeback rights, spelled out and guaranteed by law, are necessary to protect consumers and to avoid deceptive practices.

²¹² Gail Hillebrand, “Before the Grand Rethinking: Five Things to Do Today with Payments Law and Ten Principles to Guide New Payments Products and New Payments Law,” 83 Chicago-Kent L. Rev. 769 (2008).

²¹³ See National Consumer Law Center, Consumer Bankruptcy Law and Practice § 6.3.3 (9th ed. 2009 and Supp.).

²¹⁴ Mark Furletti & Stephen Smith, Federal Reserve Bank of Phila., *The Laws, Regulations, and Industry Practices that Protect Consumer Who use Electronic Payment Systems: ACH E-Checks & Prepaid Cards* at 15 (Mar. 2005), available at <http://www.philadelphiafed.org/consumer-credit-and-payments/payment-cards-center/publications/discussion-papers/2005/ConsumerProtection.pdf>.

²¹⁵ See National Consumer Law Center, Consumer Bankruptcy Law and Practice § 4.6.1 (9th ed. 2009 and Supp.).

2. Protect Loads and Access to Deposits

The complicated, multi-party nature of prepaid cards requires the CFPB to enhance Regulation E to ensure that consumers are protected if problems arise with deposits coming *into* the account and not only for transfers *out of* the account. The CFPB should also clarify the circumstances under which a card can deny access to funds. These enhancements would also be useful for traditional bank accounts.

It is not clear how or whether consumers have protection if a deposit or load of funds onto the prepaid card never reaches the account. The Regulation E liability and error resolution protections apply to a “transfer of funds,” initiated electronically, “for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit an account.”²¹⁶ Though Regulation E applies to credit *to* a consumer’s account as well as debits *from* that account, the definitions and scope of Regulation E might not apply well in the prepaid card context.

For example, consumers may load money onto their cards in a variety of ways that may not fit neatly with current Regulation E coverage:

- Paying cash in person to a retail store for a MoneyPak.
- Cashing a check at a check cashing store and asking the money to be loaded onto a card.
- Depositing cash or a check in person at a bank branch through a teller.
- Directing a tax preparer to have a refund direct deposited into a prepaid card account.

In each of these situations, it may not be clear how Regulation E applies if the money never arrives or who has Regulation E obligations if the rule does apply. The first step in most of these attempted transfers was not initiated electronically, and the party that causes the problem, or ends up with the funds, may not be the one that holds the consumer’s account. Courts have also not dealt consistently with whether attempted transfers are transfers subject to the EFTA.²¹⁷

What rights does the consumer have if the money never shows up? Does it matter if the problem is one of theft or if there was merely a mistake, such as a defective MoneyPak or a tax preparer who mistakenly got the account number wrong? What if money was transferred to the wrong account? Even if the mistake was the consumer’s, does a tax preparer, government agency or employer have an obligation to act promptly to retrieve the misdirected money? What obligations does the institution that holds the *other* account have if notified of the problem?

²¹⁶ 12 C.F.R. § 1005.3(b).

²¹⁷ Compare *McFarland v. Wells Fargo Home Mortgage*, 2006 WL 2830025 (W.D. Mich. Sept. 29, 2006) (unauthorized, and unsuccessful, attempts to debit consumer’s account, which provoked non-sufficient funds fees, are not transfers) with *Curde v. Tri-City Bank & Trust Co.*, 826 S.W.3d 911 (Tenn. 1992) (attempted deposit of check via bank ATM was “electronic fund transfer” but cancelled transaction was not).

What rights does the consumer have to insist that someone track down the problem and rectify it?

A related set of issues involves consumer's access to their funds. PayPal,²¹⁸ for example, sometimes puts a hold on the funds in a seller's PayPal account if there are allegations that the seller is engaged in deceptive conduct. Or a provider may wish to put a hold on access to a deposit if it appears that funds may have been deposited into the wrong account.

Consumers have interests on both sides of these situations. They benefit if they can get their money back from an unscrupulous seller or the wrong account. But if their account is the one placed on hold, they have an interest in clear procedures to sort out any allegations and prompt access to their funds if they are entitled to them. Regulation E's error resolution procedures may apply in these situations, but it will not always be clear, and those procedures may not be perfectly suited for these situations.

We will not attempt in these comments to propose what the rules should be. The answers are complicated and will undoubtedly vary by the situation. But we urge the CFPB to address these issues and to develop clear, universally applicable rules of the road that do not leave consumers floundering.

In general, we believe that if a prepaid card provider has chosen to use a particular method of accepting loads onto that card, the provider should be responsible for the accuracy of that method, even if it involves third parties. The provider is in a much better position than the consumer is to monitor those third parties, to understand where the problem may lie, where the money is, and how to rectify the problem, and to absorb the liabilities of occasional problems as the cost of doing business rather than a devastating loss of income.

Similarly, those who undertake to transfer or direct a transfer of money to a consumer's account should have responsibilities.

The CFPB should also develop rules that tell an institution that receives a misdirected deposit – such as an error in a direct deposit instruction or a tax preparer who deliberately diverted refunds into their own account – what it should do once it receives notice. Should it put a hold on the account until the problem is sorted out? Does the consumer have a right to insist that the money be redirected to the right account if it has not been spent? What are the rights of the holder of the account that is put on hold?

²¹⁸ PayPal accounts are GPR cards, whether or not PayPal's physical plastic card is used. They are stored value accounts accessed electronically through an "access device." The accounts are used for general purposes and are reloadable.

The corresponding rights and duties of the consumer, the party that interfaced with the consumer, an account holding institution that may have no relationship with that consumer, and the holder of that other account are not well addressed in current rules and need to be sorted out.

3. Prompt Processing of Transfers

The CFPB should also update Regulation E to ensure that when consumers make payments using prepaid cards, those payments are processed and sent to their destination in a timely fashion.²¹⁹ For example, we have heard allegations that when consumers make PayPal payments, sometimes PayPal debits the consumer's account immediately but does not credit the payment to the destination account for several days.

TILA and Regulation Z require credit card issuers to credit payments promptly,²²⁰ but there is nothing in Regulation E that specifically directs the holders of prepaid or other consumer accounts to process transfers promptly. The CFPB should require prompt processing of transfers out of accounts as well as prompt crediting of transfers into accounts.

IV. Protections, Fees and Disclosures

A. Funds Must Carry Deposit Insurance and Be Safe From Insolvency and Impediments to Access

All general use reloadable accounts, other than those that are limited to \$500 at the most and probably less, should carry deposit insurance payable to the consumer on a pass-through basis. Funds should also be required to be held in such a manner that the funds are held for the benefit of the consumer on a custodial basis and are immune from creditors. Compliance with the FDIC's deposit insurance rules achieves both purposes, and the same should be true of insurance through the National Credit Union Administration (NCUA).

Low balance cards that function more like gift cards may not need this level of protection. But any account that can hold \$500 *or* more or is capable of receiving direct deposit of wages, public benefits, retirement or other income must be safe from the insolvency of anyone involved with the card.

Pass-through deposit insurance from the FDIC or NCUA is the only means of which we are aware to give consumers complete protection from insolvency of the card issuer or others involved with the card. State money transmitter laws that require funds to be set aside may provide some protection. But if the funds are invested, they could be subject to the vagaries of

²¹⁹ The CFPB has authority under the EFTA, the purpose of which is to establish "a basic framework establishing the rights, liabilities and responsibilities of participants in electronic fund transfer systems. The primary objective of this subchapter, however, is the provision of individual consumer rights." 15 U.S.C. § 1693(b). The CFPB also has authority to prevent unfair, deceptive or abusive acts or practices.

²²⁰ 15 U.S.C. § 1666c(a); Reg. Z § 226.10(a).

the stock or bond market. And if the company becomes insolvent, the funds could be tied up in bankruptcy proceedings before they are ultimately released to the consumer. The lower income consumers who use prepaid cards cannot afford delays in access to their funds. FDIC or NCUA deposit insurance, on the other hand, is seamless and is not subject to those issues.

There can be nothing more unfair, deceptive or abusive than asking consumers to entrust a company with their income or significant funds but not holding those funds in a safe manner. The CFPB should exercise its authority, under both Regulation E and its authority to prevent unfair, deceptive or abusive practices, to require deposit insurance.

Issuers like American Express may be able to save money by avoiding deposit insurance premiums. But that illustrates why deposit insurance should be required: prepaid cards that hold the funds in a safer manner should not be at a disadvantage against those who save money by avoiding the premiums. That is the wrong type of competition to encourage.

Disclosure is completely inadequate to protect consumers from the risk of insolvency. Consumers have no way of knowing whether a company is sound or risky and cannot evaluate the importance of deposit insurance. Consumers also tend to discount unlikely future events.

Disclosures about FDIC insurance would be confusing, especially if the funds are held at an FDIC-insured institution and the website declares “Member, FDIC.” These disclosures would compete with pricing and functional information that is more salient to the consumer.

Even if consumers notice the disclosures, they are more likely to be lured by lower up-front prices or rewards than by abstract legal protection against unforeseen calamities. A rule that does not require funds to be held in accounts that carry deposit insurance may drive some companies to save on deposit insurance and hold funds in a more risky fashion.

Disclosures overall are a weak consumer protection tool.²²¹ They are a completely inappropriate form of protection for something as important as the safety of an account holding the consumers’ funds.

B. Certain Fees Should be Discouraged, Regulated or Banned

The CFPB has a responsibility to ensure that fees are not used in an unfair, deceptive or abusive manner or to evade regulatory requirements or conceal the cost of a product. The CFPB should use the tools at its disposal to ensure fair fees.

²²¹ For example, in its first effort to substantively regulate credit card practices under the FTC Act, the Federal Reserve Board noted “While the testing assisted the Board in developing improved disclosures, the testing also identified the limitations of disclosure, in certain circumstances, as a means of enabling consumers to make decisions effectively.” 73 Fed. Reg. 28904, 28905 (May 19, 2008).

Overall, the CFPB should develop rules that encourage prepaid cards to simplify fee structures; to eliminate unnecessary fees; and to give consumers the choice of a simple all-in monthly fee and an understandable pay-as-you-go model. The disclosure suggestions we have made in these comments are designed to further those goals.

Certain types of fees should also be strictly regulated or banned altogether. These fees lead to improper incentives and can lead to unfair, deceptive or abusive practices. General categories of problematic fees include:

- **Information fees.** As discussed in section III.B.2 on Regulation E modifications, consumers should not be charged fees to get information about their accounts.
- **Penalty fees.** Penalty fees should be eliminated wherever possible and strictly limited to covering the cost of the consumer's mistake. Penalty fees that enhance revenues lead providers to push consumers to take actions that trigger the penalty and misalign the interests of the provider and the consumer. Penalty fees lead to unfair, deceptive and abusive practices, just as they have with credit cards and overdraft fees.
- **Fees for exercising legal requirements.** Fees should not be used to dissuade consumers from exercising rights that they have under the law or to penalize them for doing so. For example, consumers should not be charged fees for exercising dispute rights, for stopping payment of a preauthorized transfer, or for choosing to make a payment by means other than electronic transfer.

C. The Bureau Should Develop a Single Price Tag Reflecting the Average Monthly Cost

The CFPB should develop a single price tag, similar to the annual percentage rate (APR), that can be used as a supplement to the fee chart to compare cards with different structures. That price tag should reflect the actual average use of the card by that company's customers.

Any price tag – including the price tag that a consumer will try to compute in his or her head based on the fee chart – is an approximation, merely a rough benchmark that the consumer must supplement by looking at the actual fees. The best price tag is one that is based on actual use of the particular card, by the types of consumers targeted for that card, taking into account the myriad of ways that a company may encourage or discourage consumers to incur fees. The combination of a price tag that reflects the average cost of the card and disclosure of the complete fee schedule will give consumers both the ability to compare cards and to consider variations in their own expected usage.

A fee schedule alone is insufficient. For example, two cards can carry the same ATM fees, but one might have a broad free ATM network and the other might not have any network ATMs at all. The comments of Reinvestment Partners discuss how difficult it is for consumers to know

that defect in a card. Similarly, one card might send text messages or take other measures to warn consumers when they are out of network; another might be happy to rake in the fees. Those differences will not be apparent from a fee schedule.

Disclosure of “average monthly fees” does not prevent consumers who are not “average” from finding the card that suits them. They can look at the specific fee schedules to find a card that fits their usage patterns. For example, prominent disclosure of the APR has not stopped consumers who do not carry a balance from finding cards with no annual fee or with the best rewards program.

Requiring disclosure of average monthly fees will also spur competition and give issuers an incentive to reduce that cost for *all* users. It will avoid exploitation of consumers at the far end of the spectrum who incur too many fees and avoid the deception of cards that appear cheap but have hidden dangers. Without setting any price caps, competition will drive issuers to consider methods to reach out to consumers who are incurring a number of fees.

Disclosures provide only limited consumer protection but they can be used to give providers the right incentives, which in the end are more important. Requiring that all fees be listed in the box, and that the card carry a comprehensive price tag based on actual usage, will encourage providers to compete in positive ways that consumers can understand and not based on back end or incomprehensible ways.

D. All Fees Should Be Disclosed in a Standardized Chart, on the Outside of the Package When Sold at Retail, Both Pre- and Post-Sale

The fees for prepaid cards should be displayed in a tabular (“Schumer”) box in a clear, conspicuous and prominent location visible *before* purchase. Proper disclosure of the fees on a prepaid card is the bare minimum needed to protect consumers. The CFPB should ensure that fees are disclosed in a manner that consumers actually see them, can understand them and compare them.

The regulations should also give issuers an incentive to simplify fee structures. Requiring that *all* fees be prominently displayed will create incentives for fewer and more understandable fees.

On websites, the consumer should be required to click through the bottom of a screen that discloses the fee box alone, not buried in lengthy terms and conditions. The consumer should not have to actively hunt for the fee schedule, but should be required to see it before accepting a card, and should be able to find it easily at any time.

In a retail setting, all fees should be displayed on the outside of the package. If the card has too many fees to fit on the outside of the package, the box should list, in large font, “additional fees listed on the reverse side,” with a flap that can be easily unfolded without breaking opening the package. The flap should list additional fees in large font.

All fees should be disclosed in the box, not merely the most common ones. Any card that has so many fees that they cannot be displayed on the outside of the package should not be sold in a retail environment or on a J-hook. Unusual fees will also provide unexpected and unwelcome surprises for the consumers who do incur them. They are likely to be the type of back-end fee that should most be discouraged.

Providers should not be permitted to use multiple listing of “free” features to obscure the fees that are charged. All fees should be listed in a tabular box first, before any free features are described in material that follows that box.

V. Product Features

As discussed above, overdraft fees and credit features are antithetical to the nature and purpose of prepaid cards and should be prohibited. The CFPB should also ensure that other features are not unfair, deceptive or abusive.

A. The Bureau Should Encourage and Facilitate Savings on all GPR Cards, Including Those Offered by Large Banks, But Stop Unfair or Deceptive Savings Products

The Bureau should encourage prepaid card issuers to offer savings accounts or savings features on prepaid cards. Building up savings is a much better way to protect consumers from unforeseen expenses than overdraft or credit features.

However, overdrawn transactions should not be permitted even if the card has a linked savings account. The consumer should actively choose to use savings by first transferring funds to the prepaid card account, not by inadvertently accessing them through overdraft coverage.

The CFPB should also work with the Federal Reserve Board to permit linked savings accounts on prepaid cards issued by banks over \$10 billion. As discussed above, the interchange rules under Regulation II prohibit the funds on such cards from being transferred to another account, including a savings account. That limitation was adopted to prevent banks from circumventing the interchange caps on debit cards. But a much better way is to define “prepaid card” strictly, distinct from bank accounts, as a card that has no form of credit whatsoever (including checks or electronic payments that can be initiated without simultaneously segregating the funds need to pay them).

The CFPB should prohibit any fees for savings accounts, especially inactivity fees. Charging inactivity fees on an account that is supposed to be saved and not used should be prohibited either under the Truth in Saving Act or under the authority to ban unfair, deceptive or

abusive practices. Indeed, the Federal Reserve noted the problems with inactivity fees when it banned them under the Credit CARD Act.²²²

For example, the Tandem Money savings account, described in section II.A.4 above, charges a \$5.00 inactivity fee after only 120 days without activity, defined either as deposits or withdrawals (borrowing from the savings account and credit line). The activity that the product is trying to perpetuate appears to be borrowing, not saving. Even if a savings product does not have a credit feature, inactivity fees are still inappropriate.

The CFPB should prohibit any features of a savings account that penalize a consumer for saving. The Bureau should also ensure that annual percentage yield (APY) figures are accurate, and should – in a separate rulemaking – prohibit monthly and other fees on savings accounts, which distort APYs and are inconsistent with savings.²²³

Some prepaid card issuers may choose to use rewards instead of interest to encourage savings. In the current interest rate environment, for low balance accounts, rewards might be more useful to consumers. However, the CFPB should ensure that reward rules are not manipulated to evade consumer protections or to deprive consumers of earned rewards.²²⁴

B. The Bureau Should Be Vigilant Against Deceptive Claims About Building Credit

We support the Bureau’s inquiry into the efficacy of credit building features on prepaid cards and urge the Bureau to consider rules to prevent deceptive credit building claims. Credit building features often do not deliver in the manner that the consumer expects, whether because the data is reported to a little-used agency, the data does not impact credit scores, or the data has a negative rather than a positive impact.

Indeed, the use of “alternative data” might not always be a positive for consumers. For example, as the CFPB knows, CoreLogic has recently unveiled a new product that includes information from its various consumer reporting agency databases, including TeleTrack (which is used by payday and other high cost lenders). We believe that the reporting of “alternative” data in the form of payday loan usage could harm rather than help these consumers in terms of their credit profiles and actually hinder them from obtaining affordably priced credit.

As the credit reporting industry continues research of the use of transaction data, it is possible that, in the future, reporting of prepaid card data could be a positive feature that some consumers may wish to opt in to (but only on an opt-in basis). But we fear that, in the current environment, credit building claims are more often deceptive than accurate.

²²² 75 Fed. Reg. 37526, 37547 (June 29, 2010), codified at 15 U.S.C. § 1665d.

²²³ A monthly fee works the same way as an inactivity fee by gradually reducing savings through attrition, distorting the purpose of saving.

²²⁴ With many of the traditional abuses by credit cards now forbidden by regulation, manipulative practices are now appearing in rewards programs.

VI. Other Issues on GPR Cards

A. Consumers Must Have the Choice Whether to Use a Prepaid Card

Consumers should never be required to use a particular prepaid card. Government agencies, employers and colleges and universities must always offer the clear and easy choice of direct deposit to an account of the consumer's own choosing before issuing the consumer a prepaid card. Unfortunately, that is not always the case. The CFPB should update Regulation E to ensure consumer choice.

1. Unemployment and Other Government Prepaid Cards

Many states have begun using prepaid cards to pay unemployment benefits and other government benefits. In most states, prepaid cards are a supplement to direct deposit programs. They permit states to save money and enable unbanked recipients to give their money in a safer, cheaper and more convenient fashion than waiting for and cashing a paper check.

But some states require workers to have a prepaid card account with the state's vendor in order to receive unemployment benefits. Several other states offer both direct deposit and prepaid cards, but automatically enroll workers in the prepaid card and require the workers to opt out to direct deposit.

In 2009, the Department of Labor recommended "payment of benefits by direct deposit rather than debit cards for individuals with bank accounts" and urged states to "offer the opportunity to elect direct deposit as soon as possible during the claims process."²²⁵ For states that did not yet offer direct deposit in 2009, the Department indicated that states "should, *as an interim measure*, offer a way for UC benefits to be automatically transferred from the debit card to the individual's bank account."²²⁶

Three years later, every state should be offering direct deposit to a bank account of the consumer's choosing. But an NCLC survey last year, which has been updated and remains unchanged, found that six states do not: California, Indiana, Kansas, Maryland, Nevada, and Wyoming.²²⁷ Nevada and Wyoming permit recipients to opt out of the prepaid card and receive a paper check, but in the other states, the prepaid card appears to be the only option.

²²⁵ Employment and Training Admin. Advisory System, U.S. Dep't of Labor, "Unemployment Insurance Program Letter No. 34-09 on Best Practices for Payment of Unemployment Compensation (UC) by Debit Cards," at 1-2 (Aug. 21, 2009) (DOL Debit Card Program Letter), available at http://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=2795.

²²⁶ *Id.* at 2.

²²⁷ NCLC, "Unemployment Compensation Prepaid Cards: States Can Deal Workers a Winning Hand by Discarding Junk Fees" at 9 & Appendix D at 32-33 (May 2011) (NCLC Unemployment Prepaid Card Report), available at <http://www.nclc.org/issues/unemployment-compensation-prepaid-cards.html>.

Recipients do have the ability to transfer the funds for free to a bank account, sometimes automatically and sometimes requiring a separate call after each check. But transfers, even automatic transfers, are a poor substitute for direct deposit for several reasons. The transfer may take up to two or three days for each deposit, a delay that is problematic for someone whose only income is unemployment compensation. Recipients need to figure out how to arrange the transfer and take the steps to do so. California, Kansas and Maryland allow recipients to set up an automatic transfer, but the other states may require a weekly call. Indiana has the fewest options: no direct deposit, no paper check, and no automatic transfer, forcing card holders to call customer service to perform each transfer, potentially incurring customer service fees.

The difficulty and inertia of setting up transfers means that more consumers are stuck with their funds on a prepaid card, potentially incurring fees, even though they have a bank account. As the CFPB well knows, default options are very “sticky” and many consumers will not change the default arrangement even when financially beneficial.

NCLC has conducted a new survey of the rate at which recipients of unemployment compensation opt for direct deposit to their own account, or an automatic transfer from the prepaid card if direct deposit is not available. **The survey confirms that consumers are significantly less likely to go through the hoops to have their funds transferred off of the prepaid card than they are to use direct deposit if it is offered directly.**

On average, over half of unemployment recipients select direct deposit if a state offers this option. Direct deposit rates ranged from 12% in West Virginia to 82% in Minnesota, with a median of 55%. However, West Virginia’s 12% rate reflects the fact that direct deposit was only recently added as an option. Moreover, some of the states require the recipient to opt out of the prepaid card and do not offer direct deposit at the outset.

By contrast, in the two states that provide data for automatic transfers from the prepaid card, only 24% of California workers set up an automatic transfer of funds from the prepaid card to their bank accounts and in Maryland the figure was 21%. Setting aside West Virginia, only Arizona has a lower rate of participation in direct deposit.

Clearly, offering workers a choice of payment methods results in higher use of direct deposit. States should not create barriers for workers to direct their benefits to a bank account of their choice.

At least one state, California, may have been driven by the lure of revenue sharing to require all unemployed workers to have the state prepaid card. Bank of America pays California a share of the card revenue based on the average daily balance. As of April 2012, the state had already collected \$9,521,886 during the previous 12 months.²²⁸ Most of the card revenue comes from

²²⁸ Employment Development Department, State of California, E-mail Correspondence to National Consumer Law Center (Dec. 1, 2011) (on file with NCLC).

interchange fees from merchants, but some of the card revenue is from fees on consumers. Clearly, the more workers who use the prepaid card, the more California collects.

Revenue sharing puts government agencies into a conflict position with the people they serve: they can push for the best program with the most choice and the fewest fees, or they can accept some compromises that result in more revenue for the state. California, with its enormous population of unemployed workers, was able to negotiate an excellent prepaid card, but it still has some consumer fees and is not as good as using one's one bank account.

2. College and University Card Programs

Similarly, a report by U.S. PIRG this year revealed that colleges and universities, public and private, have sometimes gone to great lengths to push students into having an account (which can be a bank account or a prepaid card account) with the institution that has a contract with the school.²²⁹ They may require the student to use a particular account to receive financial aid funds, or may obscure the student's choice or make it difficult to exercise that choice. Some programs send unsolicited cards to students and lead the student into believing that they must activate the card. Providers may also push students into choosing their account by emphasizing faster access to their money.

These pressure tactics should not be tolerated. The school can determine the student's choice ahead of time and can easily arrange for payment by alternative methods without delay. Students should not be pushed into choosing an account that they may have for years to come based solely on getting their first check two or three days earlier.

Here again, revenue sharing is a significant driver. The U.S. PIRG report found that, at just one school, Huntington Bank paid \$25 million to co-brand and link their checking accounts with Ohio State University student IDs.²³⁰ Multi-purpose ID cards may provide convenience and other benefits for students, but students should not be steered into a bank or card account that they would not choose.

Though many of the school accounts are technically bank accounts rather than prepaid cards, some are really hybrids that function more like prepaid cards. The Higher One "OneAccount," for example, does not come with a bank branch network or a significant network of free ATMs. Off campus, most ATM withdrawals will cost \$2.50 plus any surcharge from the ATM owner. Students will incur a 3.5% fee (i.e., \$17.50 for a \$500 withdrawal) to withdraw cash from a bank

²²⁹ U.S. PIRG, "THE CAMPUS DEBIT CARD TRAP: Are Bank Partnerships Fair To Students?" (May 30, 2012), available at <http://www.uspirg.org/reports/usp/campus-debit-card-trap>; see also Comments of National Consumer Law Center to Department Of Education, Office of Postsecondary Education, Negotiated Rulemaking Committee, "Public Hearings on Electronic Disbursement of Higher Education Act Funds," 34 CFR Chapter VI, Docket ID ED-2012-OPE-0008 (filed May 30, 2012), available at http://www.nclc.org/images/pdf/banking_and_payment_systems/education_prepaid_comments_may2012.pdf.

²³⁰ THE CAMPUS DEBIT CARD TRAP at 2.

teller (if, for example, the student needs more than an ATM will dispense). Students cannot use ATMs or bank branches to deposit checks and may have to pay a \$4.95 fee just to make a deposit.²³¹ That fee is not even disclosed on the fee schedule because it is a fee charged by a separate company for purchasing the MoneyPak that must be used.²³² The limitations on the account are not readily apparent from the company's website.

School programs that push consumers into using a particular account restrict student choice. Whether a student chooses to have a bank account or a prepaid card, the right choice may not be the one that has the school contract. The student may prefer an account that:

- Has a broader free ATM network, not only around the school but also in the student's home or target career city.
- Has lower fees, as smaller banks typically do.
- Has branches in the student's home state, or is where parents bank.
- Does not encourage overdraft fees or overspending.
- Has more sophisticated mobile apps and internet banking functions.
- Offers text alerts or other tools for responsible financial management.
- Is not offered by an institution that the student finds objectionable.
- Is a smaller, community based institution with more personal service.

A student can only give affirmative consent if it is clear that the student has a choice from the outset, with no predetermined defaults, and can freely choose another method of receiving funds without being disadvantaged. However, some school-selected providers are apparently manipulating that choice.

3. Employer Payroll Card Programs

Employer payroll card practices are less public and harder to monitor than school or government benefit programs. Reputable companies will always encourage direct deposit first, and state law may require it to do so and also to offer a paper check option. But it appears likely that the same

²³¹ The \$4.95 fee is the cost of purchasing a MoneyPak used to reload the card. It is not clear if any fee is charged if the student uses their smartphone to take a picture of a check and deposit it remotely. But not all students have smartphones or are aware of or comfortable with remote deposit capture.

²³² The fee can only be seen by under the "new features" icon at http://www.higherone.com/index.php?option=com_content&view=article&id=44&Itemid=82. Higher One will reimburse the fee for the first purchase. The fee schedule lists: "Add Money to the OneAccount: No additional fee." But clicking on that item reveals that the reference is only to transfers from a third party bank account, and even then the sender may incur a fee from their own bank.

pressures that are felt by government agencies and schools might persuade some employers to deliver their entire employee base to a payroll card provider without offering the first choice of direct deposit to the employee's own account.

4. The CFPB Should Clarify that Consumers Have the Choice of Using Their Own Account Before a Prepaid Card under EFTA

Government agencies, schools or employers that require consumers to have a particular prepaid card violate the EFTA, most likely in letter but definitely in spirit. The CFPB should update Regulation E to ensure that consumers always have the choice of an account of their own choosing before being pushed to use a prepaid card (or bank account) they do not select.

The EFTA provides:

No person may ... require a consumer to establish an account for receipt of electronic fund transfers with a particular financial institution as a condition of employment or receipt of a government benefit.²³³

Government agencies and schools that require a consumer to have a prepaid card account with a particular vendor are violating this provision.²³⁴ The same would be true of any employer who did the same for wages.

This EFTA rule is also violated if a consumer is defaulted into a particular account, even if the consumer can disenroll.²³⁵ A consumer cannot be required to use an account in the first place.

Similarly, the mandatory account prohibition is not avoided by permitting the consumer to transfer the funds from the prepaid card account to the consumer's personal account. The consumer is still required to have the vendor's account in the first place, and must suffer a delay of one to three days in receiving the funds.²³⁶ As discussed above, putting the onus on consumers to transfer funds out makes them more likely to be stuck using the accounts.

Practices that make it hard for the consumer to avoid enrolling in the preselected account, or deceive the consumer about the importance of choosing that account, should also be found to violate Regulation E. The CFPB should scrutinize the US PIRG report carefully for practices that should be prohibited.

Another EFTA provision also bolsters the importance of consumer choice. A financial institution is not permitted to send the consumer an *unsolicited access device*, such as a debit or

²³³ 15 U.S.C. § 1693k(2); *see* Regulation E, 12 C.F.R. § 1005.10(e).

²³⁴ Financial aid from the federal, state or local government, including a public school, is a government benefit.

²³⁵ *Cf.* *Pinkett v. First Citizens Bank*, 2010 WL 1910520 (N.D. Ill. May 10, 2010) (interpreting related ban on credit conditioned on preauthorized electronic fund transfer).

²³⁶ See UC report

prepaid card, except under limited circumstances. The card cannot be sent validated, and may be validated only later “in response to a request or application from the consumer.”²³⁷ The card must also be “accompanied by a clear explanation ... that such card ... is not validated and how the consumer may dispose of such [card] if validation is not desired.”²³⁸

The provision against unsolicited access devices applies to all prepaid cards. This provision, and the consumer’s right to dispose of an unwanted card without activation, mandate consumer choice in arenas beyond government benefits and wages.

The CFPB should amend Regulation E to ensure that these two rules – against mandated accounts and unsolicited debit cards – are honored. In particular, the CFPB should clarify:

- Government benefit recipients, workers, and other consumers who are the recipients of payments must be offered the clear, conspicuous and easy choice of direct deposit to an account of their own choosing, or a paper check, before they are given a prepaid card. The prepaid card should not be the default method out of which consumers must opt out.
- Information must be presented in a *clear, unbiased* manner, *early* in the application or paperwork process to give the consumer the clear opportunity to select another payment method and reject a prepaid card.
- Consumers must be able to exercise their choice *easily*, through electronic methods, and cannot be forced to jump through unnecessary hoops like faxing a cumbersome paper form to elect direct deposit.
- The CFPB should develop model forms to facilitate this process and to ensure that exercising choice does not delay receipt of funds.

The CFPB should also *ban revenue sharing* between prepaid card providers and government agencies, employers, schools, and other organizations that have an obligation to deliver payments to consumers. Co-branding of a card that a consumer might choose on the private market is one thing. But when an entity has an obligation to deliver a payment to a consumer, revenue sharing should not distort the payment method used or distort the consumer’s choice of accounts.

B. The Bureau Should Eliminate Pre-dispute Binding Mandatory Arbitration Clauses in Prepaid Cards

We support the Bureau’s recent commencement of its study of pre-dispute arbitration clauses and encourage the Bureau to eliminate the use of these clauses in prepaid cards.

²³⁷ 15 U.S.C. § 1693i(b)(4); *see* Regulation E, 12 C.F.R. § 1005.5(b).

²³⁸ 15 U.S.C. § 1693i(b)(3); *see* Regulation E, 12 C.F.R. § 1005.5(b)(2).

Pre-dispute arbitration clauses are used in most prepaid card terms of service. This practice is particularly disadvantageous and unfair to low-income consumers, a major constituency of these products. Because most arbitrators' decisions are final and judicial review is rarely available, companies are able to avoid scrutiny of their practices and determinations of whether they are in compliance with the law.

Pre-dispute arbitration clauses are particularly harmful to customers who use prepaid cards. These clauses are buried in the fine print of long contracts and most consumers do not notice them or understand that they are required to solve disputes with the card provider through arbitration. Virtual prepaid cards that function through mobile payment systems are even more ripe for abuse. Consumers have even less ability to read the fine print or know that they are giving up access to the courts.

Additionally, these clauses limit consumers' ability to band together and assert their rights through class actions, an efficient method to resolve similar claims from multiple customers. Absent the ability to seek redress for small-dollar claims through a class action, many prepaid card customers are unable to assert their rights. For example, it is not worth paying a \$200 to \$300 arbitration fee to seek to obtain relief for a few hundred dollars. Even when arbitration is free, it is likely to be biased. The arbitrator has a powerful incentive to rule in favor of the party who may provide repeat business. Forced arbitration simply has no place on prepaid cards.

VII. Conclusion

Prepaid cards offer promise as a vehicle for delivering a transaction account and safe payment system to consumers who have not been well served by traditional bank accounts. The market is exploding, and the time is right to extend full Regulation E protections to all general use reloadable prepaid cards.

We applaud the CFPB's effort to ensure that prepaid cards are safe, fair and appropriate for the consumers who use them. Thank you again for the opportunity to submit these comments.