

# Client Alert.

---

November 21, 2014

## Overview of the CFPB Prepaid Account Proposed Rule

By Rick Fischer, Obrea Poindexter, Ryan Rogers, and Jeremy Mandell

On November 13, 2014, the Consumer Financial Protection Bureau (“CFPB”) issued a proposed rule to regulate prepaid accounts (the “Proposed Rule”).<sup>1</sup> The Proposed Rule follows the CFPB’s May 2012 advance notice of proposed rulemaking (“ANPR”) on the same topic.<sup>2</sup> The Proposed Rule would amend certain provisions in Regulation E and Regulation Z.

The CFPB has provided a 90-day comment period, which means that comments on the Proposed Rule will be due in mid-February 2015.

### COVERAGE

The Proposed Rule would dramatically broaden the scope of the CFPB’s prepaid regulation. The Supplementary Information accompanying the Proposed Rule states that:

- The CFPB “believes that the features of non-[general purpose reloadable (“GPR”)] card prepaid products as well as the ways consumers can and do use those products warrant their inclusion as prepaid accounts,” because, for example, “inclusion aligns appropriately with the purposes of [the Electronic Fund Transfer Act]” and “[m]any consumers now use other types of prepaid products in the same ways and to fill the same needs as they did payroll card accounts”; and
- The CFPB “believes that [all prepaid] products should be considered consumer asset accounts subject to EFTA and Regulation E.”

Accordingly, and notwithstanding significant differences in the business models and consumer usage associated with various prepaid account products, the Proposed Rule would cover prepaid accounts beyond conventional network-branded general-purpose prepaid cards. The term “prepaid account” *would* include the following:

- Payroll cards;
- Certain federal, state and local government benefit cards;
- Student financial aid disbursement cards;
- Tax refund cards; and
- Certain peer-to-peer payment products.

---

<sup>1</sup> The Proposed Rule has not yet been published in the *Federal Register*. All cites herein are to the unformatted version of the Proposal posted to the CFPB’s Web site, available at [http://files.consumerfinance.gov/f/201411\\_cfpb\\_regulations\\_prepaid-nprm.pdf](http://files.consumerfinance.gov/f/201411_cfpb_regulations_prepaid-nprm.pdf).

<sup>2</sup> 77 Fed. Reg. 30,923 (May 24, 2012).

# Client Alert.

Specifically, the Proposed Rule would revise the definition of “account” under Regulation E to include a “prepaid account.” See § 1005.2(a)(3). Under the Proposed Rule, the term “prepaid account” would include a card, code or other device, established primarily for personal, family or household purposes, and not already an “account” under Regulation E, which is:

- Either (i) issued on a prepaid basis to a consumer in a specified amount, or (ii) not issued on a prepaid basis, but capable of being loaded with funds thereafter; and
- Redeemable upon presentation at multiple, unaffiliated merchants for goods or services, usable at automated teller machines, or usable for person-to-person transfers. See § 1005.2(b)(3)(i).

However, the term “prepaid account” *would not* include the following:

- Gift cards, gift certificates, or loyalty, award or promotional gift cards as defined in Section 1005.20 of Regulation E (“Gift Card Rule”);
- Payroll cards that are used to disburse solely “incentive-based payments” such as employee bonuses; or
- Health savings accounts, flexible spending accounts, medical savings accounts or health reimbursement arrangements. (Flexible spending accounts would be defined to mean cafeteria plans that provide health benefits; however, the Proposed Rule would not expressly exclude, as “flexible spending accounts,” dependent care and commuter or transit flexible spending accounts.)

## ***Non-reloadable Accounts and Third-party Loads***

The term “prepaid account” *would* cover both reloadable and non-reloadable prepaid accounts, payroll card accounts, university cards, government benefit accounts and accounts that are not loaded at acquisition but are nonetheless eligible to be loaded. The Proposed Rule also would cover prepaid products even if the funds can only be loaded by a third party, rather than by the consumer (e.g., insurance cards or cards loaded for consumers receiving workers compensation payments).

## ***Mobile Wallets***

The definition of a prepaid account under the Proposed Rule would not be limited to physical cards. The Proposed Rule would cover mobile and other electronic prepaid accounts that can store funds. Under the Proposed Rule, however, a payment product that is only capable of storing a consumer’s payment credentials, such as a digital wallet, would not be covered, provided the digital wallet is incapable of storing funds. Specifically, the proposed commentary issued with the Proposed Rule (the “Proposed Commentary”) provides that:

[A] prepaid account must either be issued on a prepaid basis or be capable of being loaded with funds. This means that the prepaid account must be capable of holding funds, rather than merely acting as a pass-through vehicle. For example, if a product is only capable of storing a consumer’s payment credentials for other accounts but is incapable of having funds stored on it, such a product is not a prepaid account. However, if a product allows a consumer to transfer funds, which can be stored before the consumer designates a destination for the funds, the product [may be viewed as a “prepaid account”]. See Comment 2(b)(3)(i)–5 (Regulation E).

# Client Alert.

The Supplementary Information states that, if a digital wallet “allows a consumer to store funds in it directly, then the digital wallet would be a prepaid account if the other criteria of the proposed definition are also met.” As a result, it appears that the Proposed Rule would subject the entire mobile wallet to new regulations if there is a portion of the wallet that can store funds.

## PREPAID ACCOUNT DISCLOSURES

### *Timing of Disclosures*

Under the Proposed Rule, short-form and long-form disclosures, consistent in form and substance with the Model Forms provided by the CFPB in the Proposed Rule, would need to be provided to a consumer prior to account acquisition, except under limited circumstances. See § 1005.18(b)(1). These disclosures must be segregated from all other materials and must only contain information that is directly related to the disclosures required under proposed Section 1005.18. The Proposed Rule contains limited exceptions to this pre-acquisition disclosure requirement for certain prepaid accounts sold in retail stores, as discussed below.

### *Short-form Disclosure Content Requirements*

Section 1005.18(b)(2)(i) sets forth the content requirements for the short-form disclosure. The required disclosures would need to be provided, “even when a particular disclosure is not applicable to a specific prepaid account product.” See Comment 18(b)(2)(i)–1 (Regulation E). In other words, even if an issuer does not charge a particular fee to a consumer, the issuer would need to include the fee name on the short-form disclosure and disclose “\$0” as the fee. (Note that, for the sake of simplicity where possible, we refer to issuers, rather than financial institutions, in this overview. The amendments to Regulation E would, however, be imposed on financial institutions, as defined in Regulation E.)

Prior to listing the fees, and in addition to other required short-form disclosures discussed below, short-form disclosures for government benefit accounts and payroll accounts would need to include a statement that the consumer does not have to accept the government benefit account (or payroll card account) and that a consumer can ask about other ways to obtain the government benefit (or wages or salary) from the government agency (or employer) instead of receiving them via the government benefit (or payroll card) account. See §§ 1005.15(c)(2) and 1005.18(b)(2)(i)(A).

In the top-line portion of the short-form disclosure, the issuer would need to disclose, using substantially similar terminology:

- Periodic fees, if any;
- Per purchase fees, including PIN and signature fees;
- ATM withdrawal fees for both in-network and out-of-network; and
- Cash reload fees. See § 1005.18(b)(2)(i)(B)(1) through (4).

Below the top-line portion of the short-form disclosure, the issuer would need to disclose:

- ATM balance inquiry fees, for both in-network and out-of-network;
- Customer service fees;
- Inactivity fees, if any; and

## Client Alert.

---

- Up to three “incidence-based” fee disclosures (discussed below). See § 1005.18(b)(2)(i)(B)(5) through (8).

Each of these fees must be disclosed in a form substantially similar to the way in which they are set forth in the Model Forms.

The short-form disclosure also would need to include:

- A statement that credit-related fees may apply;
- A statement regarding the number of fees, other than those listed on the short form, that could be imposed upon a consumer;
- A telephone number and the unique URL (no longer than 22 characters) of a Web site that a consumer may use to access the long-form disclosure;
- A statement explaining that the consumer must register the prepaid account with the issuer or a service provider in order for the funds loaded into the account to be protected;
- If the prepaid account product is *not* eligible for FDIC deposit or NCUSIF share insurance, a statement that FDIC deposit insurance or NCUSIF share insurance, as appropriate, does not protect funds loaded into the prepaid account; and
- The URL of the Web site of the CFPB.

Each of these statements must be in a form substantially similar to the way in which they are set forth in the Model Forms. See § 1005.18(b)(2)(i)(B)(9) through (14).

### ***Incidence-based Fees***

Below the top-line portion of the short-form disclosure, the issuer would need to provide, among other things, up to three “incidence-based” fee disclosures. See § 1005.18(b)(2)(i)(B)(8).

The disclosed incidence-based fees would need to be the three fees (other than the fees required to be disclosed) that were incurred most frequently in the prior 12-month period by consumers using that particular prepaid product.

At the same time each year, the issuer would need to assess whether the incidence-based fees disclosed in the prior 12-month period were the most-frequently incurred fees during that 12-month period for each prepaid account product and, if necessary, revise the incidence-based fees on disclosures provided in written, oral or electronic form within 90 days. Issuers would be permitted to choose the date of reassessment for each product. See § 1005.18(b)(2)(i)(B)(8)(I).

Following a reassessment of the most-frequently incurred incidence-based fees, new packaging materials would need to be printed that provide the short-form disclosures reflecting the current incidence-based fee assessments; however, the Proposed Rule would not require issuers to discontinue use of existing inventory (e.g., in order to meet the retail store exception to the pre-acquisition long-form disclosure). *Id.*

The incidence-based fee disclosures could require issuers to reprint disclosures on an annual basis. For each prepaid product, issuers would be required to reassess the fee incidence ranking used to determine the incidence-based portion of the product’s short-form disclosure once each year.

# Client Alert.

---

For new prepaid account products, the issuer would need to disclose the three incidence-based fees that it reasonably anticipates will be incurred by consumers most frequently during the next 12-month period. See § 1005.18(b)(2)(i)(B)(8)(II).

## ***Long-form Disclosure Content Requirements***

The long-form disclosure for a prepaid product would need to include:

- All fees that may be imposed by the issuer in connection with the prepaid account, including the amount of the fee (including any third-party fees that may apply), and the conditions, if any, under which the fee may be imposed, waived or reduced;
- The disclosures described in Regulation Z (§ 1026.60(a), (b) and (c)) if, at any point, a credit plan that would be a credit card account may be offered in connection with the prepaid account;
- The telephone number, Web site and mailing address of the person or office that a consumer may contact to learn about the terms and conditions of the prepaid account, to obtain prepaid account balance information, to request a copy of transaction history or to notify the person or office when a consumer believes that an unauthorized electronic fund transfer occurred;
- The FDIC/NCUSIF disclosure provided on the short-form disclosure; and
- The URL of the Web site of the CFPB and a telephone number a consumer can contact and the URL a consumer can visit to submit a complaint related to a prepaid account.
- The issuer may provide the long-form disclosures after a consumer acquires a prepaid account by telephone if the issuer informs the consumer orally pre-acquisition that the information required to be disclosed in the long-form disclosure is available both by telephone and on a Web site. See § 1005.18(b)(2)(ii).

The long-form disclosure would have to be provided in a stand-alone document, and such a document would be in addition to the initial disclosures generally required under Regulation E (e.g., disclosure of “[a]ny fees imposed by the [issuer] for electronic fund transfers or for the right to make transfers” (see 12 C.F.R. § 1005.7(b)(5))). Thus, the disclosures required under the Proposal are additive and, in some cases, duplicative.

## ***Formatting Requirements***

The Proposed Rule also includes very detailed and complex grouping and prominence and size (e.g., font/pixel size) requirements. See § 1005.18(b)(4). For example:

- Text in the tables would have to be all black or one color type and printed on a white or neutral contrasting background.
- Certain fee information would have to be in a minimum 11-point font or the corresponding pixel.
- Other disclosures would have minimum font size requirements between 6-point font and 8-point font.

# Client Alert.

## ***Prepaid Accounts Sold in Retail Stores***

There would be an exception for a prepaid account sold in retail stores from the requirement that the issuer provide the long-form disclosures before the consumer acquires a prepaid account. See § 1005.18(b)(1)(ii). However, the exception would only apply if:

- The prepaid account access device is inside of packaging material;
- The short-form disclosures are provided, in tabular form, on or are visible through an outward-facing, external surface of the packaging material; and
- The long-form disclosure is accessible by telephone and via a Web site. See § 1005.18(b)(1)(ii)(A)-(C).

Following an annual reassessment of the most-frequently incurred incidence-based fees in order to meet the retail store exception to the pre-acquisition long-form disclosure, new printed packaging materials providing the short-form disclosures would need to reflect the current incidence-based fee assessments. See § 1005.18(b)(2)(i)(B)(8)(I).

The Supplementary Information provides that, in a retail store that is not operated by the financial institution or an agent of the financial institution, the financial institution would be able to choose between two methods of providing the long-form disclosure: (A) provide the long-form disclosure pre-acquisition, or (B) provide the long-form disclosure post-acquisition, as permitted by the retail store exception discussed above. Based on the Proposed Commentary, however, the CFPB would apparently take the view that a retail store that exclusively offers one issuer's prepaid account products would be viewed as an agent of the financial institution and, therefore, ineligible for the retail store exception to the requirement for pre-acquisition long-form disclosures. See Comment 18(b)(1)(ii)-1 (Regulation E). Moreover, it is unclear whether a co-brand partner that operates a retail store would be viewed as an agent of the financial institution and, thus, ineligible for the retail store exception to the requirement for pre-acquisition long-form disclosures.

## ***Foreign Language Requirements***

If an issuer principally uses a foreign language on prepaid account packaging material, by telephone, in person or on the Web site a consumer utilizes to acquire a prepaid account, then the short-form and long-form disclosures would need to be provided in that same foreign language. See § 1005.18(b)(6). Nevertheless, the issuer also would need to provide the long-form disclosure in English upon a consumer's request and on any part of the Web site where it provides the long-form disclosure in a foreign language.

## ***Disclosures on Prepaid Account Access Devices***

The name of the issuer and the URL of the Web site and a telephone number a consumer can use to contact the issuer about the prepaid account would need to be disclosed on each prepaid account access device. See § 1005.18(b)(7). If an issuer does not provide a physical access device in connection with a prepaid account, the disclosure would need to appear at the URL or other entry point a consumer must visit to access the prepaid account electronically.

## ***Multiple Service Plan Prepaid Account Products***

If an issuer offers multiple service plans with different fee schedules for a particular prepaid account product, the information required for the short-form and long-form disclosures would need to be presented for all service plans. Each service plan would need to be identified using terms such as "Pay-as-you-go plan," "Monthly plan" or "Annual plan." With

## Client Alert.

respect to incidence-based fees, an issuer would need to consider the frequency with which fees are incurred for each of the plans to determine which three additional fees to disclose.

Alternatively, an issuer could disclose the required information for only the service plan in which a consumer is enrolled by default upon acquiring the prepaid account. In this case, the issuer would only need to consider the fee incidence for the default service plan. See § 1005.18(b)(3)(iii)(B).

### **BILLING STATEMENTS OR ACCESS TO ACCOUNT INFORMATION**

Under the Proposed Rule, instead of providing periodic statements as required by 12 C.F.R. § 1005.9(b), card issuers and government agencies may make available to the consumer:

- The consumer's account balance via telephone and at an ATM;
- An 18-month history of the consumer's account transactions online; and
- An 18-month written history of the consumer's account transactions in response to an oral or written request. See §§ 1005.15(d), 1005.18(c).

In contrast, the existing payroll card rule permits access to 60 days of account history as an alternative to periodic statements; thus, the Proposed Rule would significantly expand the period of account history required as an alternative to periodic statements under the payroll card rule.

Under the Proposed Rule periodic statements for a prepaid account, the electronic history of prepaid account transactions, and the written history of prepaid account transactions provided at the request of a consumer would need to disclose:

- The amount of any (and all) fees assessed against the account, whether for electronic fund transfers or otherwise; and
- A summary total of the amount of all fees assessed against the consumer's prepaid account, the total amount of all deposits to the account and the total amount of all debits from the account, for the prior calendar month and for the calendar year to date. See § 1005.18(c)(3) and (4).

These proposed requirements are similar to the requirement in the Credit Card Accountability Responsibility and Disclosure Act ("CARD Act") to disclose the total of fees on periodic statements.

### ***Additional Fee Disclosures***

The CFPB has proposed to extend to prepaid accounts the requirement to disclose the amount of any fees charged (§ 1005.18(c)(3)), consistent with the CFPB's Regulation DD (Truth in Savings), which requires that periodic statements disclose all fees debited from "accounts," as defined under that regulation (12 C.F.R. § 1030.6(a)(3)). Specifically, Regulation DD defines "account" to mean "a deposit account at a depository institution that is held by or offered to a consumer" (12 C.F.R. § 1030.2(a)); however, certain prepaid accounts may not be covered under Regulation DD (i.e., non-depository institution-issued prepaid products) and so the CFPB proposes to require a comparable disclosure.

In addition, with respect to the summary total of the amount of all fees (§ 1005.18(c) (4)), the CFPB proposes to use its "disclosure authority," pursuant to Section 1032(a) of the Dodd-Frank Act, to ensure "that the features of prepaid

# Client Alert.

accounts, over the term of the product or service, are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with prepaid accounts.”

## ***Additional Disclosures for Government Agencies***

Government agencies that elect to use the above-discussed alternative to periodic statements would need to provide initial disclosures to consumers that are different than the initial disclosures that a government agency must provide under existing 12 C.F.R. § 1005.7(b). The modified initial disclosure would need to provide a telephone number that the consumer may call to obtain the account balance, the means by which the consumer can obtain an electronic account history, and a summary of the consumer’s right to receive a written account history upon request. The modified initial disclosures would be consistent with existing 12 C.F.R. § 1005.18(c)(1) for issuers offering payroll card accounts. See § 1005.15(e)(1).

## **LIMITATIONS ON LIABILITY**

The Proposed Rule would extend the liability limitations for unauthorized transfers under the existing payroll card rule (see 12 C.F.R. § 1005.18(c)(3)) and government benefit provisions (see 12 C.F.R. § 1005.15(d)(3)) to other prepaid accounts. Specifically, the Proposed Rule would provide a 60-day period for reporting any unauthorized transfers. The 60-day period would begin on the earlier of:

- The date the consumer electronically accesses the consumer’s account information reflecting the unauthorized transfer; or
- The date the issuer (or government agency) sends the consumer a written history in response to the consumer’s request. See §§ 1005.15(e)(3)(i) and 1005.18(e)(1)(i).

An issuer or government agency could comply with this 60-day period by limiting the consumer’s liability for any unauthorized transfer reported by the consumer within 120 days after the transfer was credited to, or debited from, the consumer’s account. (Note that this safe harbor is not expressly granted to government agencies under existing Regulation E.) See §§ 1005.15(e)(3)(ii) and 1005.18(e)(1)(ii).

## ***Unverified Accounts***

Except with respect to payroll card accounts or government benefit accounts, if an issuer appropriately discloses to the consumer the risks of not registering a prepaid account in a manner consistent with the Model Forms, the issuer would not be required to comply with these liability limitations and the error resolution requirements (discussed below) for any unverified prepaid account. See § 1005.18(e)(3). The Supplementary Information states that, while the CFPB “understands that [issuers] may face difficulties in determining whether an unauthorized transaction occurred if it does not know a prepaid accountholder’s identity,” the CFPB would expect “that when a consumer calls to assert an error on an unverified account, the [issuer] would inform the consumer of its policy regarding error resolution on unverified accounts and would begin the customer identification and verification process.”

Moreover, the Proposed Commentary would provide that “[f]or an unauthorized transfer or an error asserted on a previously unverified prepaid account, whether a consumer has timely reported the unauthorized transfer or alleged error is based on the date the consumer contacts the [issuer] to report the unauthorized transfer or alleged error, not the date the [issuer] completes its customer identification and verification process,” and that “the time limits for a [issuer’s] investigation of errors...begin on the day following the date the [issuer] completed its customer identification and

# Client Alert.

verification process.” See Comment 18(e)–4 (Regulation E). Accordingly, under the Proposal, a consumer would be able to assert errors even if the transaction occurred before the prepaid account was verified.

## **ERROR RESOLUTION**

The proposed error resolution time frames and procedures for prepaid accounts in the Proposed Rule are generally the same as those currently in Regulation E. The Proposed Rule includes model language that can be used to satisfy the error-resolution notice requirement: the prepaid account disclosure would need to include contact information for the issuer (telephone number or Web site) and a statement that the consumer can contact the issuer if he or she needs information about “error resolution procedures.” See Model Form A-7.

### ***Provisional Crediting***

Notwithstanding concerns about provisional crediting and prepaid card fraud (e.g., involving tax refund cards), the Proposed Rule would extend Regulation E’s existing investigation and provisional crediting requirements to prepaid accounts. Specifically, if the issuer is unable to complete its investigation of an alleged error within 10 business days, the issuer would need to provisionally credit the consumer’s account in the amount of the alleged error (12 C.F.R. § 1005.11(c)(2)).

### ***Unverified Accounts***

Except with respect to payroll card accounts or government benefit accounts, if an issuer appropriately discloses to the consumer, consistent with the Model Forms, the risks of not registering a prepaid account, the issuer would not be required to comply with error resolution requirements for any unverified prepaid account. See § 1005.18(e)(3). However, as discussed above, reports by consumers of unauthorized transactions that occurred before an account is verified may nonetheless be timely if reported within the 60-day period that limits the consumer’s liability.

### ***Special Card Provisions and Billing Disputes Involving Prepaid Cards that are also Credit Cards***

The Proposed Rule would add a new subsection to Section 1026.13 of Regulation Z to address the applicability of both Regulation E and Regulation Z to prepaid card transactions that involve use of a credit feature that is deemed to be a “credit card” for purposes of the Proposed Rule. In connection with prepaid card transactions that access both funds in a prepaid card account and a credit feature, the prepaid card issuer must comply with provisions in both Regulation E and Regulation Z. See § 1026.13(i)(2). Specifically, the prepaid card issuer must comply with the requirements of Section 1005.11 of Regulation E, as well as the requirements of Sections 1026.13(d) and (g) of Regulation Z. If a transaction accesses only a credit feature, and does not access funds in a prepaid account, then only the Regulation Z billing error provisions apply. If a transaction accesses only funds in a prepaid account and not a credit feature, then only the Regulation E error resolution provisions apply.

### ***Claims or Defenses***

For a point-of-sale transaction where a prepaid card that is a credit card is used to obtain goods or services from a merchant and the transaction is partially funded by the consumer’s prepaid account, and partially funded by credit, the amount of the purchase transaction that is funded by the credit feature generally would be subject to the claims or defenses under 12 C.F.R. § 1026.12(c). See Comment 12(c)–5 (Regulation Z). Under the Proposed Rule, this provision would apply to transactions initiated by mail, Internet or telephone, but not to cash advances. See Comment 12(c)(1)–1 (Regulation Z).

# Client Alert.

## ***Billing Errors***

Similar to the existing Regulation Z Commentary provisions addressing financial intermediaries, such as PayPal, the Proposed Rule attempts to address prepaid accounts that are also credit cards by only subjecting the transactions to billing dispute provisions if the credit feature is used for the entire purchase of the good or service. See Comment 13(a)(3)–2 (Regulation Z). In addition, the provisional credit would only apply to that portion of the transaction that is funded by the credit feature. See Comment 13(i)–4.iii.D (Regulation Z).

## **COMPULSORY USE**

### ***Prepaid Accounts***

Currently, Section 1005.10(e)(1) of Regulation E prohibits an issuer or “other person” from conditioning an extension of credit to a consumer on the consumer’s repayment by preauthorized electronic fund transfers, “except for credit extended under an overdraft credit plan or extended to maintain a specified minimum balance in the consumer’s account.” Thus, Regulation E currently provides that an issuer may require the automatic repayment of an overdraft credit plan, even if the overdraft is charged to an open-end account that may be accessed by the consumer in ways other than by overdrafts. See Comment 10(e)(1)–2 (Regulation E).

Under the Proposed Rule, however, the CFPB would not extend this exception to prepaid accounts having an overdraft credit plan or credit feature. Instead the Proposed Rule would amend the compulsory use provision in Regulation E to cover prepaid accounts with credit features. See § 1005.10(e)(1). As a result, under the Proposed Rule, prepaid card issuers would be prohibited from requiring the repayment of amounts related to a credit feature on a preauthorized basis using amounts deposited into a prepaid account. The CFPB’s rationale for this aspect of the Proposed Rule is based, in part, on the prohibition on offsets in the Truth in Lending Act (“TILA”) and Regulation Z. The CFPB states in the Supplementary Information that it is concerned that issuers “might require that prepaid account consumers set up automated payment plans to repay the overdraft credit advances and set the payment due date for each overdraft advance to align with the expected date of subsequent deposits to the prepaid account.”

### ***Clarification of Payroll and Government Benefit Programs***

Currently, Section 1005.10(e)(2) of Regulation E provides that no issuer or other person may require a consumer to establish an account for receipt of electronic fund transfers with a particular issuer as a condition of employment or receipt of a government benefit. The CFPB states in the Supplementary Information that there was “some ambiguity surrounding compulsory use of prepaid cards to distribute non-needs tested state and local government benefits.”

To address this issue, the Proposed Rule would add a new Commentary provision to Regulation E. Specifically, this new comment would state that a government agency may not require consumers to receive government benefits by direct deposit to any particular issuer, but may require direct deposit of benefits by electronic means if recipients are allowed to choose the issuer that will receive the direct deposit. See Comment 10(e)(2)–2 (Regulation E). Alternatively, the Proposed Rule provides that a government agency may give recipients the choice of having their benefits deposited at a particular issuer (designated by the government agency) or receiving their benefits by other means. The Supplementary Information makes clear that this prohibition also would apply to payroll card accounts.

# Client Alert.

## **Amendments to Regulation Z**

Currently, Section 1026.12(d) of Regulation Z prohibits card issuers, either before or after termination of credit card privileges, from offsetting a cardholder's indebtedness arising from a consumer credit transaction against "funds of the cardholder held on deposit with the card issuer." Existing Section 1026.12(d)(3) provides, however, that the general rule on offsets "does not prohibit a plan, if authorized in writing by the cardholder, under which the card issuer may periodically deduct" the cardholder's indebtedness from a deposit account held with the issuer.

The Proposed Rule would add language to this provision of Regulation Z to clarify how the offset provisions would apply to prepaid accounts with credit features. Specifically, under the Proposed Rule, the CFPB states that the term "periodically" in 12 C.F.R. § 1026.12(d)(3) would mean "no more frequently than once per calendar month." See § 1026.12(d)(3)(ii). Thus, the Proposed Rule would restrict issuers from deducting a payment from a prepaid account more than once a calendar month.

### **PUBLIC POSTING OF PREPAID ACCOUNT AGREEMENTS**

Consistent with the rules implementing the CARD Act (12 C.F.R. § 1026.58), an issuer would be required to:

- Make quarterly submissions of its account agreements to the CFPB;
- Post prepaid account agreements to the issuer's Web site; and
- Comply with a consumer's request to provide a copy of the consumer's open account agreement if the relevant agreement is not posted to the issuer's Web site. See § 1005.19(b), (c) and (d).

The information that must be submitted to the CFPB is consistent with the rules implementing the CARD Act (12 C.F.R. § 1026.58(c)(1)), except that the issuer also would need to provide the name of the program manager, if any, for each prepaid account agreement. See § 1005.19(b)(1)(i).

The Internet posting provisions would apply to any "prepaid account," which would include "payroll card accounts" and "government benefit accounts." See § 1005.19(a)(7). In this regard, the CFPB acknowledges that issuers often negotiate payroll card account products on an employer-by-employer basis. Payroll card account products that differ only with respect to fee information would not constitute separate agreements for purposes of the posting and submission requirements (see Comment 18(g)-2 (Regulation E)); however, if the products differed in other respects, issuers would be obligated to submit and post agreements on an employer-by-employer basis, unless the payroll card account product qualifies for the *de minimis* or product testing exceptions provided under the Proposal.

Finally, the short-form and long-form disclosures and, consistent with the rules implementing the CARD Act (12 C.F.R. § 1026.58(f)), prepaid account agreements may be provided without regard to the applicable provisions of the E-SIGN Act. See §§ 1005.18(b)(3)(i)(B) and 1005.19(e).

### **OVERDRAFT AND CREDIT FEATURES**

With respect to prepaid accounts that have overdraft services or credit features, the Proposed Rule includes amendments to fundamental definitions and terms under Regulation Z. Many of the proposed amendments, which could have far-reaching implications, appear to be aimed at preventing circumvention or evasion of the credit-related restrictions under Regulation Z and Regulation E. The issues identified below are a few of the myriad issues raised by the Proposed Rule.

# Client Alert.

## ***Definition of Credit***

In general, prepaid cards that access overdraft services or credit features for a fee would be considered credit cards subject to Regulation Z and its credit card rules. In this regard, the Proposed Rule would modify the definition of “credit” under Regulation Z to include “an authorized transaction on a prepaid account where the consumer has insufficient or unavailable funds in the prepaid account at the time of authorization,” as well as “a paid transaction on a prepaid account where the consumer has insufficient or unavailable funds in the prepaid account at the time the transaction is paid.” See Comment 2(a)(14)–3 (Regulation Z).

## ***Exempt Credit Plans***

The Proposed Rule would expressly exempt a prepaid card where the “prepaid card only accesses credit that is not subject to any finance charge or any fee” and is not “payable in more than four installments.” See Comment 2(a)(7)–2 (Regulation Z). The Proposed Rule, however, would modify the definition of “finance charge” so that charges imposed for paying items that overdraw an account, or for participation in a credit plan, would be treated as finance charges when imposed in connection with credit accessed by a prepaid card or by a credit account that is established for the sole purpose of funding a specific prepaid account. See § 1026.4(b)(2)(ii). Thus, participation fees and transaction charges on the prepaid account could be considered finance charges.

## ***Overdraft Services and Prepaid Accounts***

As noted above, under the Proposed Rule, prepaid accounts with overdraft services may be considered credit card accounts for purposes of Regulation Z. See § 1026.2(a)(15)(ii)(C); see also Comment 2(a)(14). In other words, the Proposed Rule would amend Regulation Z and Regulation E so that the existing exemptions for overdraft services on traditional deposit accounts would not apply to overdraft services on prepaid accounts. In the Supplementary Information accompanying the Proposed Rule, the CFPB explains that “covering overdraft services in connection with prepaid accounts under Regulation Z aligns with TILA’s purpose...to assure a meaningful disclosure of credit terms” and that the Federal Reserve Board’s “justification of the existing regulatory approach [for deposit accounts with overdraft services] is much less convincing as applied to prepaid accounts.”

The CFPB indicates, however, that the Proposed Rule is not intended to alter existing provisions that apply to deposit account overdraft services. The CFPB notes that it “continues to study deposit account overdraft services and will propose any further enhancements to the existing regulatory framework that it deems appropriate as part of that separate endeavor in accordance with its rulemaking procedures.”

## ***Force-pay Transactions***

The Proposed Rule also would cover force-pay transactions. Specifically, the Proposed Rule would provide that “credit” includes “a transaction where the consumer has sufficient or available funds in the prepaid account to cover the amount of the transaction at the time the transaction is authorized but insufficient or unavailable funds in the prepaid account to cover the amount of the transaction at the time the transaction is paid.” See Comment 2(a)(14)–3 (Regulation Z).

Accordingly, effectively all prepaid accounts could be impacted because of the inability to control force-pay transactions, which can occur, for example, when a network is offline and uses a stand-in balance or when a merchant does not seek authorization for the full amount of a transaction. While the credit provisions are only triggered if an issuer imposes a fee

## Client Alert.

---

or charge for such force-pay transactions, if there is a negative balance on the prepaid account, the account fees (i.e., monthly service fees and transaction fees) could be viewed as a charge for a credit feature.

In other words, because it may be difficult to avoid the imposition of charges, such as monthly service fees or transaction fees, when there is a negative balance on the prepaid account, issuers would be at risk of offering a credit feature, thereby triggering the credit card requirements included in the Proposed Rule.

### ***Credit Card Requirements for Prepaid Accounts with Overdraft Services or Credit Features***

The credit provisions under the Proposed Rule, which in some respects exceed existing Regulation Z protections applicable to credit card accounts, would include:

- Performing an ability-to-repay analysis;
- Providing monthly periodic statements;
- Requiring a least 21 days to repay amounts associated with a credit feature prior to assessing any late fees, together with a requirement that such fees be “reasonable and proportional” to the account violation;
- Limiting total fees in the first year to no more than 25 percent of the initial credit limit;
- Restricting increases on interest rates applicable to use of a credit feature, unless the cardholder has missed two consecutive payments; and
- Requiring 45-day advance notice of any interest rate increases so that the consumer may cancel the credit feature.

In addition, as noted above, the CFPB has proposed to revise the compulsory use provision of Regulation E. Specifically, under the Proposed Rule, the CFPB would not extend the provision’s exception for overdraft services to overdraft features associated with prepaid accounts. These proposed changes, together with the CFPB’s proposed amendments to Regulation Z, would:

- Require prepaid card issuers to wait 30 days from the time that the consumer registers the prepaid account before offering credit features to the consumer;
- Limit the ability of an issuer to use prepaid funds to repay credit feature amounts; and
- Prohibit issuers from requiring payment within 21 days from the time the periodic statement is mailed.

### ***Prepaid Cards that Access a Credit Plan Offered by a Third Party***

The Proposed Rule would provide that a financial institution may become the agent of the card issuer if an agreement between the institution and the card issuer provides that the cardholder may use a line of credit with the institution to pay obligations incurred by use of a prepaid card that is a credit card. See Comment 2(a)(7)–1.ii (Regulation Z).

# Client Alert.

---

## UNSOLICITED ISSUANCE

As a result of the Proposed Rule's approach of treating a credit feature associated with a prepaid account as a credit card product, the CFPB proposes amendments to both Regulation E and Regulation Z to explain how the unsolicited issuance rules would apply under the Proposed Rule. Generally, the CFPB's approach is to amend Commentary provisions in both Regulation E and Regulation Z to clarify that the addition of a credit feature to a prepaid account, where the credit feature would cause the prepaid card to be deemed a "credit card," is governed by the unsolicited issuance provisions of Regulation Z. See § 1005.12(a)(2)(i); Comment 12(a)(1)–2 (Regulation Z). As a result, prepaid card issuers would be prohibited from enabling credit features on prepaid cards, unless the addition of such features was in response to a request or application. See Comment 12(a)(1)–7.i.A (Regulation Z).

\* \* \*

Below please find links to the CFPB press release; the Proposed Rule, which includes the proposed Model Forms for prepaid cards; and a related study of prepaid account agreements, issued concurrent with the Proposed Rule.

### Press Release

<http://www.consumerfinance.gov/newsroom/cfpb-proposes-strong-federal-protections-for-prepaid-products/>

### Proposed Rule

[http://files.consumerfinance.gov/f/201411\\_cfpb\\_regulations\\_prepaid-nprm.pdf](http://files.consumerfinance.gov/f/201411_cfpb_regulations_prepaid-nprm.pdf)

### Study of Prepaid Account Agreements

[http://files.consumerfinance.gov/f/201411\\_cfpb\\_study-of-prepaid-account-agreements.pdf](http://files.consumerfinance.gov/f/201411_cfpb_study-of-prepaid-account-agreements.pdf)

### Contact:

**L. Richard Fischer**  
(202) 887-1566  
[lfischer@mofo.com](mailto:lfischer@mofo.com)

**Obrea O. Poindexter**  
(202) 887-8741  
[opoindexter@mofo.com](mailto:opoindexter@mofo.com)

**Ryan H. Rogers**  
(202) 887-1507  
[rrogers@mofo.com](mailto:rrogers@mofo.com)

**Jeremy R. Mandell**  
(202) 887-1505  
[jmandell@mofo.com](mailto:jmandell@mofo.com)

### About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials in many areas. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology, and life sciences companies. We've been included on *The American Lawyer's* A-List for 11 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at [www.mofo.com](http://www.mofo.com).

*Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.*