Brooklyn Journal of Corporate, Financial & Commercial Law

Volume 5 | Issue 1 Article 9

2010

Protecting the Undeserved: Extending the Electronic Fund Transfer Act and Regulation E to Prepaid Debit Cards

Ari Cohen

PROTECTING THE UNDERSERVED: EXTENDING THE ELECTRONIC FUND TRANSFER ACT AND REGULATION E TO PREPAID DEBIT CARDS

INTRODUCTION

Millions of low- and moderate-income Americans—the "underserved"—have no traditional bank accounts or financial services.[1] The underserved, comprised of the "unbanked"—individuals and families without checking or savings accounts[2]—and the "underbanked"—those that utilize non-traditional banking[3]—rely heavily on alternative financial service providers, such as check cashing services, payday lenders, and money transmitters,[4] for most of their financial needs. These individuals and families pay high premiums for performing "basic" financial transactions in the alternative sector.[5]

In recent years, the prepaid debit card[6] has emerged as a new payment application marketed to underserved consumers who lack access to traditional banking institutions.[7] Conveniently, prepaid debit cards can be purchased at retail locations, and money can be instantaneously loaded onto the card, giving underserved consumers an account substitute that allows

---

1. Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 123 (2004) (citing studies that approximate that 8.4 million "low-income families" lacked a bank account as early as 1998).

2. FEDERAL DEPOSIT INSURANCE CORP., NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 16 (2009), *available at* http://www.fdic.gov/householdsurvey/Full_Report.pdf [hereinafter FDIC HOUSEHOLD SURVEY].

3. *Id.* at 32.

4. *See* JULIA S. CHENEY, FEDERAL RESERVE BANK OF PHILADELPHIA PAYMENT CARDS CENTER, CONFERENCE SUMMARY: PAYMENTS CARDS AND THE UNBANKED: PROSPECTS AND CHALLENGE 8 (2005), *available at* http://www.phil.frb.org/payment-cards-center/events/conferences/2005/PaymentCardsandtheUnbankedSummary.pdf [hereinafter CHENEY, PAYMENT CARDS AND THE UNBANKED].

> [T]he underserved often rely on check cashing outlets to effect certain types of transactions. In addition to cashing checks, for which they may charge from 1.5 percent to 3.5 percent of face value, these services also give underserved customers a way to transmit funds and pay bills. . . .
>
> To access a form of credit and to manage liquidity needs, the underserved often rely on payday lenders and may take out refund anticipation loans (RAL) at tax time.

Id. (summarizing "Keynote Address" by Michael S. Barr).

5. *See* Barr, *supra* note 1, at 123–24 (describing the reality that most alternative banking services "come at a high cost to low-and-moderate income borrowers").

6. Various names have been attributed to the prepaid debit card. For clarity and uniformity, the term "prepaid debit card" will be adopted for use in this note, except as otherwise discussed or quoted.

7. Rob Walker, *Social Currency: Prepaid Cards That Cash In on the Status of Plastic*, N.Y. TIMES MAG., Nov. 9, 2008, at 26.

them to make purchases, pay bills, and withdraw cash from ATMs.[8] The appeal and convenience of prepaid debit cards is clear, but users must weigh these benefits against the risks and problems incurred with their use.[9] In particular, prepaid debit card users are susceptible to complicated fee structures and security issues.[10] As the popularity of prepaid debit cards increases among the underserved, particularly in this economic climate,[11] it is important that cardholders are protected by the security of federal law.

In light of the increasing use of prepaid debit cards as an account substitute for the underserved,[12] this note calls for the extension of current federal laws, including the Electronic Fund Transfer Act (EFTA)[13] and its regulatory companion, Regulation E,[14] to this prepaid payment method. Part I of this note describes the underserved market and the obstacles to obtaining conventional banking products. Part II details the rise of the prepaid card industry and the numerous prepaid products currently available to consumers, including, among others, the prepaid debit cards, gift cards, payroll cards, and electronic benefit transfer (EBT) devices. The advantages of the prepaid debit card as an alternative to traditional financial services and as a vehicle for financially empowering the underserved, as well as the common risks incurred through use of these cards are explored in Part III. Part IV untangles the web of federal laws that currently apply to payment methods, including debit and several prepaid products. Finally, this note proposes the extension of Regulation E and the EFTA to the prepaid debit card industry to protect the financial well-being of underserved consumers who place their trust and personal finances in this payment product.

I. THE UNDERSERVED

A. WHO ARE THE UNDERSERVED?

Although "economic self-sufficiency" demands "[a]ccess to a bank account and [traditional] financial services,"[15] millions of Americans lack

---

8. *Stored Value Cards: An Alternative for the Unbanked?*, FED. RESERVE BANK OF N.Y. (July 2004), http://www.ny.frb.org/regional/stored_value_cards.html [hereinafter FED. RES. BANK OF N.Y., *Stored Value Cards*].

9. *Id*.

10. *See id*.

11. *See* Walker, *supra* note 7.

12. *See* James Flanigan, *As Credit Cards Falter, the Cash Variety Gains Popularity*, N.Y. TIMES, Mar. 19, 2009, at B9 (describing the rise in popularity of "the business of prepaid cash cards").

13. Electronic Fund Transfer Act of 1978, Pub. L. No. 95-630, 92 Stat. 3728 (1978) (codified as amended at 15 U.S.C.).

14. Electronic Fund Transfers (Regulation E), 12 C.F.R. §§ 205.1–205.18 (2009).

15. FEDERAL DEPOSIT INSURANCE CORP., FDIC SURVEY OF BANKS' EFFORTS TO SERVE THE UNBANKED AND UNDERBANKED: EXECUTIVE SUMMARY OF FINDINGS AND RECOMMENDATIONS 3 (2009), *available at* http://www.fdic.gov/unbankedsurveys/unbankedstudy/FDICBankSurvey_ExecSummary.pdf [hereinafter FDIC BANK SURVEY].

access to checking or savings accounts or do not fully participate in the financial system.[16] Few statistics accurately represent the number of unbanked and underbanked families in the United States; however, one recent study estimates that more than seven percent—or approximately nine million—of U.S. households are unbanked,[17] and at least 21 million households are underbanked.[18]

"[R]easons [that] the underserved do not or cannot use traditional banking [methods]" can generally be categorized as "demand-based" and "supply-based."[19] Demand-based factors encompass the "preferences and needs" of the underserved.[20] There are several reasons the unbanked may believe they are ill-suited for conventional banking.[21] Regular checking accounts may not be sensible for those that cannot afford "high overdraft . . . [and] maintenance fees, prohibitive minimum balances . . . . [or] delays associated with having deposited checks credited."[22] Despite increased flexibility offered by banks, documentation requirements pose barriers to account ownership for the working poor and immigrants.[23] Physical inaccessibility also poses an obstacle to account ownership, as banking institutions are not as readily accessible in lower-income communities as more affluent ones.[24] The unbanked may also be barred from establishing bank accounts due to unfavorable credit histories or prior failures in managing bank accounts.[25] Finally, a "lack of financial education" also affects the demand for conventional banking among the unbanked.[26]

Conversely, supply-based factors, such as "cost or marketing considerations," have affected the way financial institutions engage the

---

16. *Id.*; *see also* CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 6; Walker, *supra* note 7.

17. FDIC HOUSEHOLD SURVEY, *supra* note 2, at 10.

18. *Id.* at 10.

19. CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 7.

20. *Id.*

21. *See* Barr, *supra* note 1, at 124–25, 177–84 (listing a laundry list of factors that hinder the underserved from obtaining bank accounts); *see also* CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 7–8 (describing the difference between demand-based and supply-based barriers to banking access for the underserved).

22. CHENEY, PAYMENT CARDS AND THE UNBANKED*, supra* note 4, at 7; *see also* Barr, *supra* note 1, at 177–81 (identifying "high minimum balances, monthly fees and the risk of bouncing checks" as major reasons why banking accounts make little "economic sense" for low-income families).

23. Barr, *supra* note 1, at 184. Fears that poorly documented immigrants would be unable to access banking systems have led to various accommodations. *Id.* "[M]atricula consular cards are widely accepted as a suitable form of identification for opening noninterest-bearing . . . checking account[s]"; however, an "IRS-issued . . . taxpayer ID number or Social Security number is required to open an interest-bearing account." CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 7 (citations omitted).

24. Barr, *supra* note 1, at 182–83; CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 7.

25. Barr, *supra* note 1, at 181.

26. *Id.* at 183–84.

unbanked market.[27] Because banking the poor is unlikely to produce high returns,[28] financial institutions may be reluctant—despite improvements in technology that make it more affordable to offer "meaningful banking products" to the poor[29]—to make the initial investments, such as "product development, . . . marketing and [financial] education," required to enter the market.[30] As a result of these circumstances, an overwhelming number of Americans have turned to the alternative financial sector and prepaid products as substitutes for account ownership.[31]

II. THE PROLIFERATION OF THE PREPAID CARD INDUSTRY

A. WHAT IS A PREPAID CARD?

A prepaid card is a "credit-card sized" product that represents an amount of "pre-loaded value."[32] Prepaid cards differ from credit cards "which draw their value from a line of credit, [and] debit cards, which draw their value from a [personal] checking account, [because] the value on a prepaid card" is derived from funds that have been pre-loaded.[33] Transactions involving prepaid cards require accessing a remote database for account information and payment authorization.[34] Prepaid cards employ "magnetic stripe" technology and have a card number associated with an

---

27. CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 7.

28. Michael S. Barr, *Banking the Poor: Policies to Bring Low-Income Americans Into the Financial Mainstream* 4 (Univ. of Michigan Law Sch. Law & Economics Working Paper Series, Paper No. 48, 2004), *available at* http://law.bepress.com/cgi/viewcontent.cgi?article=1048&context=umichlwps.

29. *See* CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 7–8.

30. Barr, *supra* note 1, at 183.

31. *See* Walker, *supra* note 7; *see also* Barr, *supra* note 1, at 177.

32. Mark Furletti, *Prepaid Card Markets & Regulation* 2 (Fed. Reserve Bank of Phila. Payment Card Center, Discussion Paper No. DP04-01, 2004), *available at* http://www.phil.frb.org/payment-cards-center/publications/discussion-papers/2004/Prepaid_022004.pdf [hereinafter Furletti, *Prepaid Card Markets*]; Mark Furletti & Stephen Smith, *The Law, Regulations, and Industry Practices That Protect Consumers Who Use Electronic Payment Systems: ACH E-Checks & Prepaid Cards* 13 (Fed. Reserve Bank of Phila. Payment Cards Center, Discussion Paper No. DR05-04, 2005), *available at* http://www.phil.frb.org/payment-cards-center/publications/discussion-papers/2005/ConsumerProtection.pdf.

Although most sources use the terms "prepaid cards" and "stored-value cards," interchangeably, the Federal Reserve Board has distinguished these terms. *A Summary of the Roundtable Discussion on Stored-Value Cards and Other Prepaid Products*, FED. RESERVE BOARD OF PHILA., http://federalreserve.gov/paymentsystems/storedvalue/#fn3r (last visited Oct. 24, 2009) [hereinafter *Summary of Roundtable Discussion*]. The Board associates the term "stored-value" with "products for which prefunded value is recorded on the payment instrument." *Id.* These cards typically have an embedded microchip that stores information about the card's value on the card. Furletti, *Prepaid Card Markets*, *supra* at 2 n. 2. The Board associates the term "prepaid" with "products for which the prefunded value is recorded on a remote database, which must be accessed for payment authorization." *Summary of Roundtable Discussion*, *supra*. The term stored-value card will not be used in this note.

33. Furletti, *Prepaid Card Markets, supra* note 32, at 2.

34. *Summary of Roundtable Discussion*, *supra* note 32.

account maintained by the issuing financial institution.[35] The card, therefore, functions as an access device to the consumer's funds.[36] "[P]repaid describes most of the products on the market today."[37]

The prepaid card industry provides an array of products.[38] Prepaid cards, however, can generally be divided into two categories: closed-loop and open-loop cards.[39] Closed-loop cards, such as prepaid gift, phone, or transit cards, can be used only for the particular merchant's or issuer's products.[40] Open-loop cards, on the other hand, can be used for multiple purposes and at multiple points of sale.[41] These cards can be used for making purchases, paying bills, or making ATM withdrawals, and some, including prepaid debit cards, have the ability to be reloaded.[42] Open-loop cards include payroll, government benefit, and prepaid debit cards.[43]

B. HISTORY OF THE PREPAID CARD INDUSTRY

Compared with traditional payment methods, "the prepaid card industry is still in [its] early stages of development."[44] Historically, prepaid cards emerged as a replacement for "paper-based" and related payment devices, such as gift certificate and transit tokens.[45] Closed-loop prepaid products were first introduced by transit systems and college campuses in the

---

35. *See* Furletti, *Prepaid Card Markets*, *supra* note 32, at 2 n. 2.

36. *Id.* at 2.

37. *See Summary of Roundtable Discussion*, *supra* note 32.

38. While prepaid cards are often referred to, interchangeably, as stored-value cards, these terms can be distinguished. *See Summary of Roundtable Discussion*, *supra* note 32 (distinguishing between the two terms by indicating that unlike stored-value cards, that the value of prepaid cards is recorded "on a remote database"). "Stored value cards are a form of prepaid card . . . ." NATIONAL COMMUNITY INVESTMENT FUND, DEMYSTIFYING PREPAID CARDS: AN OPPORTUNITY FOR THE COMMUNITY DEVELOPMENT BANKING INSTITUTION SECTOR 1 (2009), *available at* http://www.ncif.org/images/uploads/20090921_NCIF_DemystifyingPrePaidCards.pdf [hereinafter DEMYSTIFYING PREPAID CARDS].

39. *See, e.g.*, FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8; Furletti, *Prepaid Card Markets*, *supra* note 32, at 2 (listing prepaid card systems into "closed, semi-closed, semi-open, and open" categories); Julia S. Cheney & Sherrie L.W. Rhine, *Prepaid Cards: An Important Innovation in Financial Services* 2 (Fed. Reserve Bank of Phila. Payments Cards Center, Discussion Paper No. DP06-07, 2006), *available at* http://www.phil.frb.org/payment-cards-center/publications/discussion-papers/2006/D2006JulyPrepaidCardsACCIcover.pdf.

40. FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8; Furletti, *Prepaid Card Markets*, *supra* note 32, at 2.

41. FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8; Furletti, *Prepaid Card Markets*, *supra* note 32, at 2.

42. FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8; Furletti, *Prepaid Card Markets*, *supra* note 32, at 8.

43. *Summary of Roundtable Discussion*, *supra* note 32; Furletti, *Prepaid Card Markets*, *supra* note 32, at 8.

44. DOVE CONSULTING, FED. RESERVE SYSTEM, THE ELECTRONIC PAYMENTS STUDY: A SURVEY OF ELECTRONIC PAYMENTS FOR THE 2007 FEDERAL RESERVE PAYMENTS STUDY 28 (2008) [hereinafter DOVE CONSULTING, ELECTRONIC PAYMENTS STUDY].

45. *Summary of Roundtable Discussion*, *supra* note 32.

1970s.[46] In the 1980s, prepaid telephone cards emerged in the prepaid market.[47] The prepaid industry expanded exponentially in the mid-1990s when national retailers introduced closed-loop gift cards to replace gift certificates.[48] In the early-1990s, EBT cards became the first open-loop cards introduced to replace paper-based food stamps.[49] Since the mid-1990s, a number of open-loop prepaid cards have been introduced to consumers.[50] Today, prepaid cards have a wide range of purposes. Anyone calling family abroad with a prepaid phone card, purchasing clothing at a retailer with a gift card, or buying groceries and paying monthly bills with a prepaid debit card is taking advantage of the variety of prepaid products now available to consumers.[51]

Prepaid cards have become one of the fastest growing products in the financial industry.[52] As a result of the industry's continuous growth and ever-changing prepaid product applications, the size of the prepaid market is unclear.[53] However, the most recent study performed by the Federal Reserve Board estimated that prepaid transactions in 2006 totaled about $49.9 billion, including $13.3 billion in open-loop transactions.[54]

C. TYPES OF PREPAID CARDS

1. Prepaid Debit Cards

Like other forms of prepaid cards, prepaid debit cards differ from traditional card-based products in that they require users to pay early for purchases that will be made in the future rather than paying at the time or after purchases are made.[55] Prepaid debit cards are, however, similar to traditional credit and debit cards in that both allow customers to "withdraw funds from ATMs . . . [and] . . . make retail purchases or pay bills, in person, online or over the phone."[56] The cards can also be reloaded with additional funds in a variety of ways, including "direct deposit, money wire transfer, money order," or by paying cash at retail locations.[57] Typically, the

---

46. Kathleen L. DiSanto, *Down the Rabbit Hole: An Adventure in the Wonderland of Stored-Value Card Regulation*, 12 J. CONSUMER & COM. L. 22, 23 (2008).

47. *Id.*

48. *See Summary of Roundtable Discussion*, *supra* note 32; DiSanto, *supra* note 46, at 23. National retailers such as Blockbuster and Kmart are credited with introducing these cards. Cheney & Rhine, *supra* note 39, at 2.

49. *Summary of Roundtable Discussion*, *supra* note 32.

50. *See id.*

51. *See, e.g.*, FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8; *Summary of Roundtable Discussion*, *supra* note 32.

52. *See* FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8.

53. *See* DOVE CONSULTING, ELECTRONIC PAYMENTS STUDY, *supra* note 44, at 27–30.

54. *Id.* at 39; DEMYSTIFYING PREPAID CARDS, *supra* note 38, at 1.

55. Cheney & Rhine, *supra* note 39, at 2.

56. CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 5.

57. FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8.

consumer's pre-loaded funds are stored in and drawn from a "pooled account" or "cardholder sub-account" held by the issuing financial institution.[58]

The infrastructure that makes prepaid debit cards available and functional for consumers is immense. The industry's hierarchy is comprised of issuers, providers, processors, brand networks, debit networks, ATM networks, reload networks, and retailers.[59] Recognizing the potential of the underserved market, financial institutions have integrated prepaid debit cards into their product lines, serving as issuers and providers of cards as well as holders of pre-loaded fund accounts.[60] However, retailers are increasingly competing against banks as providers of prepaid debit cards.[61] For example, Wal-Mart has been rather successful in the market since it began selling prepaid debit cards in June 2007.[62] The growing number of retailers that provide such cards—coupled with their ability to conduct financial transactions in their stores—has blurred the line, particularly for the underserved, as to what constitutes traditional banking.[63] Processors authorize payments, clear transactions, and provide a variety of services for financial institutions that issue prepaid cards.[64] Brand networks, such as Visa, MasterCard, Discover, and American Express, "provide connections between the merchant's bank and the issuing financial [institution]."[65] Debit networks "allow PIN Debit transactions [to take place] at the point of sale," and ATM transactions are made possible by ATM networks.[66] Reload networks, such as Green Dot, MasterCard repower, MoneyGram, Visa ReadyLink, NetSpend, and nFinanSe, provide the computer servers, software, and customer service that allow prepaid debit cardholders to reload money at a growing network of retail locations.[67] Prepaid debit cards can be obtained in numerous retail locations, including convenience, drug and grocery stores, via phone or Internet, and at check cashing services.[68]

---

58. Cheney & Rhine, *supra* note 39, at 8.

59. DEMYSTIFYING PREPAID CARDS, *supra* note 38, at 4.

60. *See id.* at 1. Banks that are interested in offering prepaid debit cards can choose from three models: hire companies to develop a prepaid card program, build a program in-house or outsource some functions while retaining control of others. *Id.* at 6.

61. *Id.* at 2.

62. *Id.* (quoting Ann Zimmerman, *Wal-Mart User Fees for its Prepaid Visa Debit card*, WALL. ST. J., Feb. 18, 2009, http://online.wsj.com/article/SB123496685897511383.html).

63. CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 18.

64. DEMYSTIFYING PREPAID CARDS, *supra* note 38, at 4.

65. *Id.*

66. *Id.*

67. *Id.* at 4; James Flanigan, *supra* note 12.

68. SHERRIE L. W. RHINE ET AL., THE CENTER FOR FINANCIAL SERVICES INNOVATION, CARDHOLDER USE OF GENERAL SPENDING PREPAID CARDS: A CLOSER LOOK AT THE MARKET 5 (2007), *available at* http://cfsinnovation.com/system/files/imported/managed_documents/general_spending_prepaid_cards.pdf.

Issuers of prepaid debit cards have developed a "two-step process for distributing prepaid general spend cards."[69] "[C]onsumers purchase temporary, instant issue [] cards [that provide] immediate access to their funds."[70] Consumers are then issued a permanent card bearing the same account number and often embossed with the card bearer's name, only after the temporary card has been loaded and additional personal information provided to the issuing institution.[71]

These days, access to prepaid debit cards is as easy as shopping for groceries.[72] In 2008, transactions on prepaid debit cards totaled more than $4 billion.[73] This number was expected to increase to $7.2 billion in 2009 and $10.8 billion in 2010.[74] Prepaid debit cards have become one of the fastest growing products in the consumer banking industry.[75]

2. Gift Cards

A gift card—the modern incarnation of paper-based gift certificates—can be used to purchase goods or services from merchants. Although gift cards represent the majority of prepaid products issued, they actually "account for proportionately less of the total value loaded onto [prepaid] cards."[76] Currently, two types of gift cards dominate the market: closed-loop, merchant issued gift cards and branded or open-system gift cards.[77] Merchant issued gift cards—those that can be used only at the merchant's locations[78]—were the first widely distributed prepaid product.[79] Branded gift cards, on the other hand, are "redeemable . . . anywhere the network brand on the card is accepted."[80] Recently, a competitive struggle has

---

69. *Id*.
70. *Id.*
71. *Id.*
72. *See* Andrew Martin, *Prepaid, but Not Prepared for Debit Card Fees*, N.Y. TIMES, Oct. 6, 2009, at A1.
73. Flanigan, *supra* note 12.
74. *Id.*
75. Martin, *supra* note 72.
76. Julia S. Cheney, *Prepaid Card Models: A Study in Diversity* 6 (Fed. Reserve Bank of Phila. Payments Card Center, Discussion Draft No. DP05-04, 2005), *available at* http://www.phil.frb.org/payment-cards-center/publications/discussion-papers/2005/PrepaidCard Models_Palmer_FINAL.pdf [hereinafter Cheney, *Prepaid Card Models*].
77. *See* MARK FURLETTI, FED. RESERVE BANK OF PHILA. PAYMENT CARDS CENTER, CONFERENCE SUMMARY: PREPAID CARDS: HOW DO THEY FUNCTION? HOW ARE THEY REGULATED? 7, 14 (2004), *available at* http://www.phil.frb.org/payment-cards-center/events/conferences/2004/PrepaidCards_062004.pdf [hereinafter FURLETTI, HOW DO THEY FUNCTION?].
78. *Id.* at 7.
79. *See* DOVE CONSULTING, ELECTRONIC PAYMENTS STUDY, *supra* note 44, at 28 (citing Blockbuster and Kmart as the pioneers in developing prepaid gift certificates).
80. Cheney, *Prepaid Card Models*, *supra* note 76, at 5–6.

ensued between these two products;[81] however, closed-loop gift cards still continue to dominate the overall prepaid card market.[82]

3. Payroll Cards

Payroll card programs are a cost-saving replacement to paper payroll checks, allowing employers to translate paychecks into card-based value.[83] Similar to the process of direct deposit, the value loaded onto payroll cards is done automatically by transferring the payroll amount from the employer's account to the employee's payroll card account.[84] Like prepaid debit cards, payroll card accounts are usually managed via a "third-party processor."[85] Payroll cards are similar to debit cards linked to a checking account and provide many similar functions, including ATM functionality, the ability to purchase goods and services and receive cash back from a transaction, and access to "real-time balance information."[86]

Payroll cards have become quite attractive to the underserved population. In 2004, payroll cards were issued to at least 1.8 million unbanked households,[87] and many expect significant growth within the underserved market.[88] Payroll cards appeal to underserved consumers because they eliminate check cashing lines and fees, "offer immediate access to pay," and provide consumers with the ability to withdraw as much money as desired.[89] The increase in the popularity of payroll cards is also, in large part, attributable to the branding of payroll cards by Visa and MasterCard.[90] The Visa or MasterCard brand provides payroll cards with debit card-like functionality and prestige.[91]

4. Electronic Benefit Transfers

"Electronic benefit transfer (EBT) programs are designed to deliver government benefits such as food stamps, supplemental security income (SSI), and social security."[92] EBT programs function similarly to payroll cards; "[e]ligible recipients receive magnetic-stripe cards and personal

---

81. FURLETTI, HOW DO THEY FUNCTION?, *supra* note 77, at 7.

82. DOVE CONSULTING, ELECTRONIC PAYMENTS STUDY, *supra* note 44, at 30.

83. *See Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked*, COMMUNITY DEVELOPMENTS (Comptroller for the Currency, Washington, D.C.), June 2005, at 1, *available at* http://www.occ.gov/static/community-affairs/insights/payrollcards.pdf [hereinafter *Payroll Cards: An Innovative Product*].

84. Cheney, *Prepaid Card Models*, *supra* note 76, at 7.

85. *Id*.

86. *Id.*

87. *Payroll Cards: An Innovative Product*, *supra* note 83, at 2.

88. *See id.* at 10 (discussing bankers who recommend payroll cards to employers).

89. *Id.* at 4.

90. *Id.*

91. *See id.*

92. Electronic Fund Transfers, 62 Fed. Reg. 43,467, 43,467 (Aug. 14, 1997) (to be codified at 12 C.F.R. pt. 205).

identification numbers" that access their benefits electronically.[93] In recent years, government use of EBT programs has become increasingly popular, as states embrace the cost-effectiveness and speed of electronic disbursement of benefit funds.[94] "Currently all states use EBT cards to [dispense] food stamps and TANF program benefits," and many states have started issuing child support payments and unemployment benefits through prepaid cards.[95] In early 2008, the Treasury Department announced that it would begin issuing Social Security benefits through prepaid cards.[96]

III. THE ADVANTAGES AND DISADVANTAGES TO PREPAID DEBIT CARD USE

Prepaid debit cards have been heavily marketed to the underserved for a variety of reasons.[97] Prepaid cards provide the underserved with a more convenient way of accessing funds and making transactions without the obstacles of account ownership.[98] Despite notable conveniences, however, underserved consumers are often uneducated about the array of features, fee structures, and lack of protections attributed to prepaid debit cards.[99]

A. WHY THE UNDERSERVED USE PREPAID DEBIT CARDS

Prepaid debit cards can be "irresistible" to the underserved for many reasons.[100] First, prepaid debit cards provide a limited form of safety and security compared to other alternative financial products,[101] because they allow consumers to make purchases and pay bills without carrying cash.[102] Second, prepaid debit cards offer immediate liquidity, making loaded funds available instantaneously, rather than the delays associated with traditional

---

93. *Id.*

94. DOVE CONSULTING, ELECTRONIC PAYMENTS STUDY, *supra* note 44, at 31.

95. *Id.*

96. Eleanor Laise, *Treasury Plans Social Security Debit Card; A Bid for Payments to Become Cheaper and More Secure*, WALL ST. J., Jan. 4, 2008, at A4.

97. FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8.

98. CENTER FOR FINANCIAL SERVICES INNOVATION, PREPAID CARD VS. CHECKING ACCOUNT PREFERENCES (2008), http://cfsinnovation.com/system/files/imported/managed_documents/prepaid_sept9_0001.pdf.

99. *See* FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8.

100. *See* MICHAEL J. HERMANN & RACHEL SCHNEIDER, CENTER FOR FINANCIAL SERVICES INNOVATION, NONPROFIT DISTRIBUTION OF PREPAID CARDS 5–6 (n.d), *available at* http://cfsinnovation.com/system/files/imported/managed_documents/cfsi_nonprdistprepaid_mar08.pdf.

101. Alternative financial service providers include check cashing outlets, payday lenders, money transmitters, and pawnshops. *Financial Access Options for the Underserved*, FED. RESERVE BANK OF DALLAS BANKING & COMMUNITY PERSP., no. 3, 2009 at 2, *available at* http://www.dallasfed.org/ca/bcp/2009/bcp0903.pdf.

102. SARAH GORDON, ET. AL., CENTER FOR FINANCIAL SERVICES INNOVATION, A TOOL FOR GETTING BY OR GETTING AHEAD? CONSUMERS' VIEWS ON PREPAID CARDS 6 (n.d), *available at* http://cfsinnovation.com/system/files/imported/managed_documents/voc-prepaidfinal.pdf.

check cashing.[103] Furthermore, unlike traditional bank accounts, prepaid debit cards are easily accessible and impose no identification or credit history requirements.[104] For example, one card advertises, "'No Credit Check. Safer Than Cash. No Bank Account Needed.'"[105] Consumers can simply purchase a prepaid debit card at a checkout register and begin performing transactions.[106]

An indirect advantage to prepaid debit card use is that other options in the alternative financial sector are extremely costly. The underserved rely heavily on check cashing outlets, which often charge between 1.5 and 3.5 percent of face value.[107] It has been estimated that the check cashing industry earns about $1.5 billion in fees each year processing 180 million checks with a face value of $55 billion.[108] These fees are extraordinarily high "both in absolute terms and relative to the customer's income."[109]

B. POTENTIAL OF PREPAID DEBIT CARDS TO FINANCIALLY EMPOWER THE UNDERSERVED

Many industry participants acknowledge that prepaid debit cards can serve as a vehicle towards greater financial empowerment of the underserved.[110] Russell Simmons, a contributing creator of the Prepaid Visa RushCard, was inspired by his belief that prepaid debit cards can provide the underserved with "access to the American dream."[111] Despite the alarming number of Americans that remain unbanked or underbanked,[112] research shows that the underserved are not opposed to using banks.[113] Rather, these individuals have been unable to overcome an "intimidation factor" to gain access.[114] Prepaid debit cards, however, are widely believed to be the entry-level products that can help the underserved overcome this fear.[115] Recognizing this potential, banks are beginning to adapt cards and practices to meet the needs of the underserved, offering credit-building features[116] and developing distribution relationships with third-party

103. *See* HERMANN & SCHNEIDER, *supra* note 100, at 5.
104. *Id.* at 6.
105. *See* Martin, *supra* note 72 (quoting language from Visa'Green Dot Prepaid Card).
106. *Id.*
107. CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 8.
108. *Id.*
109. *Id.*
110. *See id.* at 15–16.
111. Walker, *supra* note 7.
112. *See* FDIC HOUSEHOLD SURVEY, *supra* note 2.
113. CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 15.
114. *Id.*
115. *See* FED. RES. BANK OF N.Y., *Stored Value Cards, supra* note 8.
116. *Id.*

providers connected to underserved communities.[117] Financial institutions have seized the opportunity to use prepaid debit cards as an opening to the underserved market,[118] and the results could be significant for banks and the underserved.

C. THE RISKS ASSOCIATED WITH PREPAID DEBIT CARDS

Despite their convenience and appeal, financially uneducated consumers are often unaware of the risks associated with the use of prepaid debit cards. First, users are susceptible to an array of hidden fees generated through the cards' use.[119] Banks that offer prepaid debit cards to consumers make money from a number of fees that are commonly incurred with card usage, including entrance or activation fees, maintenance fees, point of sale fees, and ATM transaction fees.[120] Potential additional fees include transaction limit fees, bill payment fees, phone or online transaction fees, reload fees, inactivity fees, overdraft and overdraft protection fees, and even fees to call customer service.[121] For consumers, this astounding range of fees[122] only serves to increase the complexity of the fee structure for each

117. *See* CHENEY, PAYMENT CARDS AND THE UNBANKED, *supra* note 4, at 16 (advancing the "need to develop distribution relationships with third-party providers that have direct relationships with [the underserved]").

118. *See* DEMYSTIFYING PREPAID CARDS*, supra* note 38, at 1.

119. *See, e.g.*, Martin, *supra* note 72.

120. FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8.

121. *Id*. Fees vary widely among the numerous cards marketed to consumers. For example, the MiCash Prepaid MasterCard charges a $9.95 activation fee, $1.75 for ATM withdrawals, $1 for ATM balance inquiries, $0.50 for purchases, $4 for monthly maintenance, $2 for inactivity over 60 days, and $1 for calls placed to customer service. *See* Walker, *supra* note 7. The Millennium Advantage Prepaid MasterCard requires an application fee up to $99. *Id.* "The Silver Prepaid Mastercard . . . [has] the option of charging a $25 shortage fee if customers exceed their balance," despite advertising that it does not charge for overdrafts. *Id.* The Prepaid Visa RushCard costs $19.99, charges $1 per transaction, has ATM fees of $1.95 plus fees charged by the ATM's owner, and charges fees to add money in the form of cash. *Id*.

122. The following chart displays the relevant fee categories and ranges of fees associated with prepaid debit cards:

Fee Type	Fee Range
Entrance/Activation	$0 to $39.95
Maintenance	
Monthly	$0 to $9.95
Annual	$0 to $99.95
Point of Sale	$0 to $2.00

card,[123] leaving one spokesman for a consumer advocacy group asking, "[h]ow are consumers supposed to keep the fees straight if the companies can't?"[124] The costs make prepaid debit cards "a very expensive way to bank," causing some to question whether it is right to give "people their pay on a card that has fees on it."[125]

Second, prepaid debit cards lack some of the basic legislative and regulatory protections extended to other payment devices.[126] Only recently have fee limitations been imposed,[127] but these laws do not apply to prepaid debit cards.[128] Presently, there is no legislatively mandated error resolution procedure when funds are stolen from the card's account or unauthorized charges are made.[129] Unlike credit and debit cards, prepaid debit cards are not protected by consumer liability caps[130] or a right of recredit.[131] Nor do prepaid debit cards have a statutory chargeback right, which allows a consumer to reverse a payment when the goods ordered are not delivered.[132] Finally, not all prepaid debit cards may have federal deposit insurance to protect funds in the event of bank failure.[133]

IV. FEDERAL LAWS CURRENTLY APPLYING TO THE PREPAID INDUSTRY

The myriad of products and laws in the payment products market is complex and confusing.[134] The EFTA and Regulation E provide the legal

---

Domestic ATM Transaction (within network)	\$0 to \$2.50

FED. RES. BANK OF N.Y., *Stored Value Cards, supra* note 8.

123. *See id.*

124. Martin, *supra* note 72.

125. *Id.*

126. *See generally* 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 CHI.-KENT L. REV. 769 (2008).

127. *See* Credit CARD Act of 2009 § 102, 15 U.S.C.A. §§ 1637(j)–(k), 1661 (West 2010).

128. Philip Keitel, *The Credit CARD Act of 2009 and Prepaid Cards*, FED. RESERVE BANK OF PHILA. PCC NOTE PAYMENT CARDS CENTER, (Aug. 2009), http://www.philadelphiafed.org/payment-cards-center/publications/pcc-note/2009/pcc-note_credit-card-act-2009.pdf.

129. *See* Hillebrand, *supra* note 126, at 772 ("[A] consumer who pays by debit card . . . does not have a statutory right to reverse the charge.").

130. *Id.* at 775–77. When money is taken from an account or an unauthorized charge is made to a payment device, a consumer liability cap provides a limit on the amount of money a cardholder can lose before the problem is discovered and reported. *Id.* at 775.

131. *Id.* at 779. A right of prompt recredit protects cardholders by returning money to their account after money has been unlawfully taken or the card has been charged without the account holder's consent. *Id.*

132. *Id.* at 781.

133. *See* FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8.

134. Mark Furletti, *Payment System Regulation and How it Causes Consumer Confusion* 1 (Fed. Reserve Bank of Phila. Payment Cards Center, Discussion Paper No. DP04-05, 2004), *available at* http://www.phil.frb.org/payment-cards-center/publications/discussion-papers/2004/

framework governing the movement of electronic funds, including debit and several prepaid products.[135] For simplicity's sake, uniformity would be beneficial to all market participants—consumers, the card industry, and regulators.[136]

A. EFTA AND REGULATION E

In 1978, Congress passed the EFTA to "provide a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer systems," with the "provision of individual consumer rights" as the primary objective.[137] The EFTA requires "financial institutions to send consumers monthly statements [detailing] transaction activity," implement procedures to resolve erroneous transfers, and "limit consumer liability for unauthorized transfers."[138] In the EFTA, Congress delegated to the Board of Governors of the Federal Reserve System (the Board) the responsibility for promulgating regulations to carry out its purposes.[139] Regulation E was originally enacted by the Board in part to extend the protections of the EFTA to debit cards.[140] Today, the protections of the EFTA and Regulation E apply to several prepaid payment methods, including government benefits[141] and payroll cards,[142] and were most recently expanded to gift cards and general-purpose prepaid cards.[143]

1. Protections of the EFTA and Regulation E

The EFTA and Regulation E provide important protections for consumers who use electronic fund transfer services, [144] which include debit and some prepaid card users. These protections include a liability cap and the right to prompt recredit when money is taken out of an account or a charge is made without the account holder's authorization,[145] limitations on financial institutions' ability to assess overdraft fees,[146] and disclosure

---

PaymentSystemRegulation_112004.pdf (last visited Oct. 24, 2009) [hereinafter Furletti, *Payment System Regulation*].

135. Furletti, *Prepaid Card Markets*, *supra* note 32, at 13–14.

136. Furletti, *Payment System Regulation*, *supra* note 134, at 7.

137. Electronic Fund Transfer Act of 1978, Pub. L. No. 95-630, § 902, 92 Stat. 3728, 3728 (1978).

138. Christopher B. Woods, *Update on Prepaid Cards Laws and Regulations*, 61 CONSUMER FIN. L. Q. REP. 815, 815 (2007).

139. 15 U.S.C. § 1693b(a) (2006).

140. *See* Electronic Fund Transfers (Regulation E), 12 C.F.R. §§ 205.1(a)–(b) (2009).

141. *Id.* § 205.15.

142. *Id.* § 205.18.

143. Credit CARD Act of 2009 § 401, 15 U.S.C.A. § 1693*l* (West 2010).

144. 15 U.S.C. § 1693b(a); 12 C.F.R. § 205.1(b).

145. 15 U.S.C. §§ 1693f–1693g; 12 C.F.R. § 205.6 (2009).

146. In November 2009, the Board announced final rules that prohibit financial institutions from charging overdraft fees on ATM or one-time debit transactions unless a consumer consents. Press Release, Board of Governors of the Federal Reserve System, Federal Reserve Announces Final Rules Prohibiting Institutions from Charging Fees for Overdrafts on ATM and One-Time

requirements that inform consumers about how these protections apply.[147] However, consumers purchasing cards that have the appearance of debit cards may be surprised to discover that these look-a-likes are treated rather differently.[148]

The EFTA and Regulation E provide two protections for consumers whose accounts are victimized by unauthorized electronic fund transfers (i.e., withdrawals or charges against the account "initiated by a person other than the consumer without actual authority to initiate the transfer and from which the consumer receives no benefit.")[149] First, the laws provide a liability cap that sets the amount a consumer can be held responsible for to $50, $500, or unlimited liability depending upon when the consumer discovers and reports the loss or theft.[150] The laws also require that financial institutions investigate an alleged error or unauthorized transaction and promptly recredit a consumer's account if the investigation reveals an error.[151] Brand networks, like Visa and MasterCard, also provide "additional voluntary protection, with significant loopholes in coverage."[152]

A recent development was the Board's announcement that Regulation E will limit financial institutions' ability to charge overdraft fees for ATM transactions and one-time transactions that overdraw a consumer's account unless the consumer consents to these fees.[153] This amendment, which took effect in summer 2010, will undoubtedly curb the growth of overdraft fees, which cost consumers $23.7 billion in 2008.[154] Not surprisingly, lower-income Americans pay the majority of these fees.[155] Overdraft fees, however, are not the only type of fees targeted by Congress and the Board; the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) prohibits the assessment of dormancy fees, inactivity charges, or service fees with respect to the covered forms of payment.[156]

The EFTA and Regulation E also require a financial institution to make disclosures when the "consumer contracts for the electronic fund transfer service"[157] or "before the first electronic fund transfer is made involving the

---

Debit Card Transactions (Nov. 12, 2009), http://www.federalreserve.gov/newsevents/press/bcreg/20091112a.htm [hereinafter Overdraft Fees Press Release].

147. 12 C.F.R § 205.7(b) (2009).

148. Anita Ramasastry, *Confusion and Convergence in Consumer Payments: Is Coherence in Error Resolution Appropriate?*, 83 CHI.-KENT L. REV. 813, 836 (2008).

149. 15 U.S.C. § 1693a(11) (2006); 12 C.F.R. § 205.2(m) (2009).

150. 15 U.S.C. § 1693g(a).

151. *Id.* § 1693f(a)–(b).

152. Hillebrand, *supra* note 126, at 777.

153. Overdraft Fees Press Release, *supra* note 146.

154. *The Overdraft Protection Act of 2009: Hearing on H.R. 3904 Before the H. Comm. on Financial Services*, 111th Cong. 136 (2009) (statement of Eric Halperin, Director, Center for Responsible Lending).

155. *Id.* at 137 (citation omitted).

156. Credit CARD Act of 2009, 15 U.S.C.A. § 1693*l*-l(b)(1) (West 2010).

157. 15 U.S.C. § 1693c(a)(1) (2006).

consumer's account."[158] These disclosures include, among other things, a summary of the consumer's liability for unauthorized fund transfers,[159] "the consumer's right to stop payment of a preauthorized electronic fund transfer,"[160] "[a]ny fees imposed by the financial institution for electronic fund transfers or for the right to make transfers,"[161] "notice that a fee may be imposed by an [ATM] operator"—and "any network used to complete the transaction"—when the consumer makes an ATM withdrawal or a balance inquiry.[162]

2. Prepaid Payment Methods Protected by the EFTA and Regulation E

The protections of the EFTA and Regulation E apply only to "account[s]" as defined therein. Regulation E defines an "account" as "a demand deposit (checking), savings, or other consumer asset . . . held directly or indirectly by a financial institution and established primarily for personal, family, or household purposes."[163] As one author has noted, the scope of this definition and the implications it has on protecting prepaid debit cards are quite unclear.[164] The Board has added to this confusion by expressing its own uncertainty as to whether prepaid debit cards fall within the definition of a consumer asset account.[165] However, the historical development of congressional and Board efforts to regulate the prepaid industry is rather convincing evidence that neither the EFTA nor Regulation E currently regulate prepaid debit cards.[166]

a. Electronic Benefits

There have been several attempts to expand the coverage of Regulation E. In 1994, the Board amended the regulation to bring EBT programs within its coverage.[167] These provisions applied many of Regulation E's

---

158. Electronic Fund Transfers (Regulation E), 12 C.F.R. § 205.7(a) (2009).
159. *Id.* § 205.7(b)(1).
160. *Id.* § 205.7(b)(7).
161. *Id.* § 205.7(b)(5).
162. *Id.* § 205.7(b)(11).
163. *Id.* § 205.2(b)(1).
164. Hillebrand, *supra* note 126, at 790 (maintaining that it is unclear whether the EFTA currently applies to prepaid debit cards); *but see* Ramasastry, *supra* note 148, at 836 ("At present, if a consumer uses a prepaid or stored-value card, there is no legislatively-mandated error resolution procedure (with the exception of payroll cards)."); Martin, *supra* note 72 (stating that "prepaid cards have not undergone . . . Congressional and regulatory scrutiny").
165. *See* Electronic Fund Transfers, 61 Fed. Reg. 19,696, 19,698–99 (May 2, 1996) (to be codified at 12 C.F.R. pt. 205).
166. *See supra* Part IV.A.1–2. For example, the Board explicitly expanded Regulation E only to payroll cards in 2007, and Congress specifically exempted prepaid debit cards from the Credit CARD Act of 2009. *See* 15 U.S.C.A. § 1693*l*-1(a)(2)(D) (West 2010); 12 C.F.R. § 205.18 (2006).
167. Electronic Fund Transfers, 59 Fed. Reg. 10,768, 10,768 (Mar. 7, 1994).

protections, including a liability cap[168] and error resolution procedures.[169] The Board, however, exempted government agencies from furnishing periodic statements of account activity if the agency made recipients' account balances available via telephone and electronic terminals and provided written account histories upon request.[170] The Board's rationale for these amendments was that all consumers using EFT services should uniformly receive the protections under the EFTA and Regulation E.[171]

b. Consideration of Prepaid Cards, in General

In 1994, the Board also first considered whether all prepaid cards should receive the protections of Regulation E.[172] After receiving comments, the Board proposed amendments to Regulation E in May 1996.[173] These proposed rules would have imposed modified requirements on three classes of prepaid products: "off-line *accountable* stored-value systems," "off-line *unaccountable* stored-value systems, and "*on-line* stored-value systems."[174] The Board defined "on-line stored-value systems" as the following:

> [B]alance of funds that may be accessed only through the use of a card that a consumer may use at electronic terminals to obtain cash or purchase goods or services, where the record of such balance is maintained on a separate database, and not on the card, and where on-line authorization of transactions is required to access the funds.[175]

This category of prepaid cards, which the Board considered to be "the functional equivalent of a deposit account accessed by a debit card," closely resembles the prepaid debit card; however, the Board recognized that not all on-line stored-value cards are reloadable.[176] Therefore, this definition presumably included products such as branded or open-looped gift cards in addition to prepaid debit cards.

The proposed rule would have applied to several prepaid products that were not exempted by a de minimis exception for cards issued for below $100.[177] However, the prepaid industry protested that these protections would stifle product development,[178] and, in response, Congress directed

168. Electronic Fund Transfers (Regulation E), 12 C.F.R. § 205.15(d)(3) (2009).
169. *Id.* § 205.15(d)(4).
170. *Id.* § 205.15(c).
171. Electronic Fund Transfers, 62 Fed. Reg. 43,467, 43,467 (August 14, 1997) (codified at 12 C.F.R. pt. 205).
172. Ramasastry, *supra* note 148, at 835.
173. *Id.* (citations omitted); Electronic Fund Transfers, 61 Fed. Reg. 19,696, 19,696 (May 2, 1996) (codified at 12 C.F.R. pt. 205).
174. Electronic Fund Transfers, 61 Fed. Reg. at 19,699 (emphasis in the original).
175. *Id.* at 19,704.
176. *Id.* at 19,702.
177. *Id.* at 19,703 (emphasis in the original).
178. Furletti, *Prepaid Card Markets*, *supra* note 32, at 11.

the Board to evaluate whether the EFTA or Regulation E "could be applied to electronic stored-value products without adversely affecting the cost, development, and operation of such products."[179] The Board issued its response in 1997, concluding that these regulations might suppress innovation and development of prepaid products.[180] Nevertheless, the Board conceded that compliance with Regulation E requirements would not be "a significant problem" for these cards.[181]

c. Payroll Cards

The Board's stance on prepaid cards remained stagnant until September 2004, when it published proposed rules to extend Regulation E to payroll cards.[182] The Board's primary justification for this expansion was the acknowledgment that payroll cardholders needed basic legal protections because their livelihoods depended on the funds loaded on to such cards.[183] This proposal was followed by an announcement of the approval of a final rule extending Regulation E to payroll cards in August 2006.[184]

This extension was implemented by amending the definition of "account" to include "payroll card account[s]," defined as:

> 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 . . . 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.[185]

The Board modified the requirements for furnishing periodic statements for payroll card accounts—similar to those modifications for electronic benefits[186]—by exempting financial institutions from providing account transaction information to card users as long as it makes available the

---

179. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REPORT TO THE CONGRESS ON THE APPLICATION OF THE ELECTRONIC FUND TRANSFER ACT TO ELECTRONIC STORED-VALUE PRODUCTS 1 (1997), *available at* http://www.federalreserve.gov/boardDocs/rptcongress/efta_rpt.pdf.

180. Ramasastry, *supra* note 148, at 836.

181. Electronic Fund Transfers, 61 Fed. Reg. at 19,699, 19,702. The Board recognized that "because [this] system operate[s] on-line," the system was already "designed to [protect] against unauthorized access, and compliance with limitations on consumer liability" would be similar to those for "traditional deposit account[s] accessed by debit card[s]." *Id.*

182. Woods, *supra* note 138, at 815–16.

183. Mark E. Budnitz, *Developments in Payments Law 2008: Creative Consumer Lawsuits and Robust Government Enforcement*, 12 J. CONSUMER & COM. L. 2, 4 (2008).

184. Press Release, Board of Governors of Federal Reserve System, Approval of Final Rule Covering Payroll Card Accounts Under Regulation E and a Request for Public Comment on an Interim Final Rule (Aug. 24, 2006), http://www.federalreserve.gov/newsevents/press/bcreg/20060824a.htm. "According to the [Board], '[t]he broad characteristics of payroll card accounts led the FRB to conclude that payroll card accounts are appropriately classified as [deposit] accounts.'" Woods, *supra* note 138, at 815.

185. Electronic Fund Transfers (Regulation E), 12 C.F.R. § 205.2(b)(2) (2009).

186. 12 C.F.R. § 205.15(c) (2009).

consumer's account balance via telephone, a 60-day electronic history of account transactions, and a 60-day written history of the consumer's transactions upon the consumer's request.[187]

B. THE CREDIT CARD ACT AND REGULATION E SECTION 205.20

In May 2009, President Barack Obama signed the Credit CARD Act into law.[188] Although primarily aimed at regulation of credit card issuing practices, several provisions focus on prepaid cards.[189] Title IV of the Credit CARD Act, titled "Gift Cards," amended the EFTA.[190] When the Act took effect in early 2010, it significantly impacted segments of the prepaid card industry, notably those that fell within the "[A]ct's definition of 'general-use prepaid card,' 'gift certificate,' and 'store gift card.'"[191] The Act defines "general-use prepaid card" as a:

> [C]ard or other payment code or device issued by any person that is –
>
> (i) redeemable at multiple, unaffiliated merchants or service providers, or automatic teller machines;
>
> (ii) issued in a requested amount, whether or not that amount may, at the option of the issuer, be increased in value or reloaded if requested by the holder;
>
> (iii) purchased or loaded on a prepaid basis;
>
> (iv) and honored, upon presentation, by merchants for goods and services, or at automated teller machines.[192]

The Act, however, specifically exempts prepaid debit cards.[193] Section 915(a)(2)(D) provides "the term[] 'general-use prepaid card' . . . do[es] not include an electronic promise, plastic card, or payment code or device that

---

187. *Id.* § 205.18(b)(1).
188. Credit CARD Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (codified as amended in scattered sections of 15 U.S.C.).
189. Keitel, *supra* note 128.
190. 15 U.S.C.A. § 1693*l*-1 (West 2010).
191. Keitel, *supra* note 128.
192. 15 U.S.C.A. § 1693*l*-1(a)(2)(A). A store gift card was further defined as:

> [A]n electronic promise, plastic card, or other payment code or device that is—
>
> (i) redeemable at a single merchant or an affiliated group of merchants that share the same name, mark, or logo;
>
> (ii) issues in a specified amount, whether or not that amount may be increased in value or reloaded at the request of the holder;
>
> (iii) purchased on a prepaid basis in exchange for payment; and
>
> (iv) honored upon presentation by such single merchant or affiliated group of merchants for goods or services.

Id. § 16931*l*-1(a)(2)(C).
193. *See id.* § 1693*l*-1(a)(2)(D).

is . . . (ii) reloadable and not marketed or labeled as a gift card or gift certificate."[194] Furthermore, the corresponding amendments to Regulation E issued by the Board in April 2010,[195] also make clear that prepaid debit cards are not protected by these changes.[196] Section 205.20(b)(2) states "[t]he terms 'gift certificate,' 'store gift card,' and 'general-use prepaid card' . . . do not include any card, code, or other device that is . . . reloadable and not marketed or labeled as a gift card or gift certificate."[197]

Nevertheless, Title IV and Regulation E now provide several important protections for general-use prepaid cards and gift cards, including limitations on fees and expiration and disclosure requirements.[198] The Act makes it unlawful, except as otherwise provided, to impose "a dormancy fee, an inactivity charge or fee, or a service fee with respect to [covered forms of payment]."[199] The Act also requires disclosure, demanding that the certificate or card clearly and conspicuously inform consumers of applicable fees and how and when these fees will apply.[200] The Credit CARD Act and the amendments to Regulation E are the most recent actions taken to protect consumer rights in the prepaid card industry,[201] but as prepaid debit cards become increasingly popular,[202] Congress and the Board must consider extending protections further.

V. ENSURING THE FINANCIAL SECURITY OF UNDERSERVED PREPAID DEBIT CARD USERS THROUGH UNIFORM FEDERAL REGULATION

Congress passed the EFTA after determining that a major void existed in consumer protection laws covering electronic fund transfers, "leaving the rights and liabilities of consumers, financial institutions, and intermediaries in electronic fund transfers undefined."[203] The intent of Congress was exceptionally clear; its primary objective was the "provision of individual consumer rights" for Americans who had placed their trust in electronic

194. *Id*.

195. Electronic Funds Transfer, 75 Fed. Reg. 16,580, 16,582 (Apr. 1, 2010) (codified at 12 C.F.R. § 205.20) (2010) (amending Regulation E to adopt reforms made to gift cards, gift certificates, and general-use prepaid card under the Credit CARD Act).

196. *See id.* at 16,592–94.

197. *Id.* at 16,614.

198. *See* 15 U.S.C.A. § 1693*l*-1(b)–(c); *see also* Electronic Funds Transfer, 75 Fed. Reg. at 16,614–15 (codified at 12 C.F.R. § 205.20(c), (d), (f)).

199. 15 U.S.C.A. § 1693*l*-1(b)(1); Electronic Funds Transfer, 75 Fed. Reg. at 16,614–15 (codified at 12 C.F.R. § 205.20(d)) (disallowing dormancy, inactivity, and service fees under certain conditions).

200. 15 U.S.C.A. § 1693l-1(b)(3); Electronic Funds Transfer, 75 Fed. Reg. at 16,614–15 (codified at 12 C.F.R. § 205.20(c)–(d)).

201. Keitel, *supra* note 128.

202. *See* Walker, *supra* note 7.

203. Electronic Fund Transfer Act of 1978 § 902, 15 U.S.C. § 1693(a) (2006).

fund transactions.[204] In setting out to achieve this goal, Congress granted the Board comprehensive regulatory authority.[205]

Over the last several years, Congress and the Board have taken notice of the growing popularity and practicality of the prepaid industry as a modern payment method for the underserved and population at large.[206] In response, Congress and the Board have regulated several popular prepaid products, including EBT transfers,[207] payroll card accounts,[208] and gift cards.[209]

However, uncertainty about whether the EFTA and Regulation E currently apply to prepaid debit cards has caused considerable confusion.[210] In fact, the Board has even suggested that prepaid debit cards may already fall within the purview of Regulation E.[211]

To ensure the security and support the legitimacy of this growing financial industry, the Board must provide clarification. The most effective way to achieve this result is to explicitly extend Regulation E to prepaid debit cards. Specifically, the Board should amend the definition of "account," as was most recently done to incorporate payroll accounts, and adopt a new section to Regulation E that specifies the protections and modified requirements for prepaid debit cards.

A. EXTENDING REGULATION E TO PREPAID DEBIT CARDS

Amending Regulation E to redefine "account" to include "prepaid debit account" would provide much needed clarity as to how prepaid debit cards are protected by Regulation E and the EFTA.[212] Gail Hillebrand has suggested amending the definition of "account" to include:

> [A] 'spending account,' which is an account that is directly or indirectly established by the consumer and to which prepayments on behalf of the consumer by the consumer or by others, including but not limited to loan

204. *Id.* § 1693(b).

205. *See id.* § 1693b. The Board has determined that the legislative history of the EFTA provides broad guidance as to the Board's regulatory authority for determining issues of coverage of prepaid cards. *See* Electronic Fund Transfers, 61 Fed. Reg. 19,696, 19,696 (May 2, 1996).

206. Woods, *supra* note 138, at 815.

207. Electronic Fund Transfers (Regulation E), 12 C.F.R. § 205.15 (2009).

208. *Id.* § 205.18.

209. Credit CARD Act of 2009, 15 U.S.C.A. § 1693*l*-1 (West 2010); 12 C.F.R. §§ 205.15, 205.18.

210. Ramasastry, *supra* note 148, at 815–16.

211. *See* Electronic Fund Transfers, 61 Fed. Reg. at 19,699. In proposed rules issued in 1996, the Board considered extending Regulation E to three categories of prepaid cards, including "on-line" stored value cards, which operate through on-line access to a remote database to access account data and authorize transactions. *Id.* At that time, the Board believed that these cards "me[t] the definition of a consumer asset account, and thus [were] covered by Regulation E." *Id.* Nevertheless, the Board proposed modified rules for these cards that were never adopted. *Id.* at 19,702.

212. Hillebrand, *supra* note 126, at 795.

> proceeds or tax refunds, of an amount greater than $250 in any calendar year may be made or to which recurring electronic fund transfers may be made by or at the discretion of the consumer, or from which electronic fund transfers may be made at the discretion of the consumer. . . . This definition shall include all accounts into which funds are placed at the discretion of the consumer that meet the conditions of this definition, whether or not the account is held in the name of the consumer or the name of another entity. For purposes of this definition, a spending account is an account that holds funds that are transferred into the account by the consumer or by an entity who owes those funds to the consumer, even if the funds in the account are held in a pooled fashion in the name of another.[213]

Ms. Hillebrand's proposal is closely based on the amendment to Regulation E incorporating payroll accounts.[214] This hypothetical definition extends the protections of Regulation E to a broad range of "prepaid stored-value cards."[215]

However, a narrower definition of account—focused specifically on prepaid debit card accounts—is more likely to win the support of the Board. First, the Board has regularly chosen to make incremental modifications to Regulation E rather than comprehensive changes.[216] Second, regulation of prepaid debit cards is more urgent as the industry continues to grow, particularly among underserved users.[217] Finally, discretion should be left to the Board to determine the dollar threshold that triggers the protections of Regulation E. Accordingly, the proposed amendment to the definition of "account" in hypothetical 12 C.F.R. § 205.2(b)(4) should be:

> The term 'account' includes a 'prepaid debit card account' which is an account that is established by a consumer and to which electronic fund transfers, constituting prefunded value, are made on a recurring basis by or on behalf of the consumer that may be accessed only through use of a card at the discretion of the consumer, whether the account is held directly or indirectly by a financial institution.

The Board should also amend the definition of "financial institution" to include "any person that, directly or indirectly, holds a [prepaid debit account], or that issues a card to a consumer for use in obtaining cash or purchasing goods or services by accessing such an account."[218]

---

213. *Id.* at 796.
214. *Id.*; *see also* 12 C.F.R. § 205.2(b)(2) (2009).
215. Hillebrand, *supra* note 126, at 795.
216. *See supra* Part IV (discussing amendments made by the Board to other prepaid products).
217. *See* Walker, *supra* note 7.
218. Electronic Fund Transfers, 61 Fed. Reg. 19,696, 19,704 (May 2, 1996).

Certain fee limitations, similar to those that now cover gift cards, gift certificates, and general-use prepaid cards,[219] should also be adopted by the Board and applied to prepaid debit cards.

Furthermore, issuing financial institutions should be permitted to provide modified disclosures, similar to exceptions adopted for EBT transfers, payroll card accounts, and gift cards, gift certificates, and general-use prepaid cards, including account information disclosure and error resolution notice.[220]

Finally, in adopting a new section of Regulation E, the Board should exempt prepaid debit cards from particular compliance requirements to address concerns about the economic costs of regulatory compliance.[221] Rather than requiring periodic statements that detail account activity, an issuer should be required to provide account balances and account histories online or by telephone, and provide written histories only upon consumers' request.[222]

B. OPPOSITION TO BOARD ACTION

The Board has been reluctant to extend the protections of Regulation E to prepaid debit cards despite considering action several times.[223] Rather, the Board has acceded to the opposition of issuers, brand networks, and other industry participants—those profiting from prepaid debit cards rather than those consuming them.[224] Today's arguments against regulating prepaid debit cards are not novel. In fact, these arguments have been raised

---

219. *See* 12 C.F.R. § 205.2(d).

220. *See id.* §§ 205.15(d), 205.18(c), Appendix A-7(a)–(b).

221. *See Ramasastry*, *supra* note 148, at 842. In the 1996 proposed rules, the Board recommended to exempt on-line stored value systems completely from coverage if the maximum amount that could be prefunded on the card was limited to $100. Electronic Fund Transfers, 61 Fed. Reg. at 19,703. The justification for this de minimis exemption was quite practical. If the value associated with a card is limited to a small amount, the cost of Regulation E compliance would be disproportionately greater. *See id.* at 19,701 ("For a stored value product limited to a relatively small amount of funds, the amount at risk would be sufficiently minimal that application of even modified Regulation E prosecutions appears unnecessary."). However, this proposal was based upon the Board's determination that on-line stored value systems included non-reloadable products. *Id.* at 19,702 ("In some on-line stored-value systems, cards are not reloadable. . . ."). Since it would be an impossibility to determine whether a consumer would, over the course of a prepaid debit cards use, pre-load at least $100 on the card, it is impractical to apply this de minimis exemption for prepaid debit cards.

222. The Board proposed an exemption from the periodic statement requirement for all reloadable on-line stored-value cards based on the assumption that since the value is only accessible through the card itself, period statements are not necessary because the consumer will receive a receipt for each transaction. Electronic Fund Transfers, 61 Fed. Reg. at 19,702. A similar modification has been adopted for EBT transfers and payroll card accounts, and therefore, seems appropriate and not unduly burdensome for issuers of prepaid debit cards as well. *See* 12 C.F.R. § 205.15.

223. Ramasastry, *supra* note 148, at 835–36.

224. *See* Furletti, *Prepaid Card Markets*, *supra* note 32, at 14.

for over a decade, since the Board first considered widespread regulation of the prepaid industry.[225]

The linchpin of the prepaid industry's argument against extending federal regulation has been on the grounds that compliance with Regulation E will be too costly and will stifle product development.[226] In particular, issuers are concerned that Regulation E's account balance and history statements requirements are unduly burdensome.[227] However, issuers' fears may be quelled by the fact that any previous extensions implemented by the Board applied modified disclosure requirements.[228] In addition to concerns about cost, the industry has voiced strong opposition on the grounds that regulation will curb development of this relatively young product.[229] This argument is enhanced by a belief that regulations developed in a different time and context cannot be appropriately applied to regulate prepaid debit cards.[230]

Nevertheless, regulation is crucial at this time. Although prepaid debit cards are considered to be in their infancy—particularly when compared to closed-loop systems, which date back to the 1970s[231] and the initial open-loop systems introduced in the mid-1990s[232]—the prepaid debit card industry has flourished, and according to industry researchers, will have more than doubled in volume in 2010 from 2008 totals.[233] The industry is ripe for regulation.

Issuers and providers also often assert that regulation is unnecessary because the brand networks, like Visa and MasterCard, have "voluntarily" adopted "zero liability" policies and error resolution procedures that protect prepaid debit card consumers.[234] However, these voluntary policies are arbitrarily applied, limited in scope, and provide less than adequate

---

225. *See id.*

226. *See* FURLETTI, HOW DO THEY FUNCTION?, *supra* note 77, at 16 ("The industry argued against the proposal for fear that it would halt the development of prepaid products.").

227. *See* Furletti, *Prepaid Card Markets*, *supra* note 32, at 14 ("If issuers were forced to adhere to certain sections of Regulation E and . . . mail monthly statements to prepaid card customers and provide liability protections . . . [then] many current prepaid business models [might not] be profitable.").

228. *See* 12 C.F.R § 205.15(d) (applying modified disclosure requirements to EBT transfers of government benefits); 12 C.F.R. § 205.18(b) (2009) (applying modified disclosure requirements to Payroll Accounts).

229. *See* Consumer Advisory Council, Transcript of the Consumer Advisory Council Meeting 48 (Mar. 30, 2006), *available at* http://www.federalreserve.gov/aboutthefed/cac/cac_20060330.htm#efta (testimony of member Joshua Peirez).

230. *See id.* ("[T]aking regulation set that's developed in one context and applying it wholesale to brand new products that were not even envisioned at the time that the regulation was written is not always the best way to go.").

231. DiSanto, *supra* note 46, at 23.

232. *Id.*

233. Flanigan, *supra* note 12.

234. *See* Letter from Gail Hillebrand et al., Consumer Union, to Jennifer L. Johnson, Sec'y, Bd. of Governors of the Fed. Reserve Sys. (Oct. 28, 2004), *available at* http://www.consumersunion.org/pdf/payroll1004.pdf.

protection for consumers affected by lost or stolen cards and unauthorized use.[235]

Along a similar vein, some industry officials have argued that fees have been declining.[236] A recent industry-sponsored study found that some cards, including those marketed by Green Dot, Wal-Mart, and NetSpend, compare favorably against the costs of traditional checking accounts, defying many of the negative misconceptions associated with prepaid debit cards.[237] Nevertheless, a failure to regulate has left consumers paying arbitrary and egregious fees that they neither expect nor understand.[238]

C. CONGRESSIONAL ACTION: AMENDING THE EFTA

Despite the Board's powerful grant of regulatory authority, it has continued to succumb to industry pressures,[239] taking a piecemeal approach to regulating the prepaid card industry.[240] Therefore, it may become necessary for Congress to reconsider its original objective in passing the EFTA—protecting consumer rights[241]—and take matters into its own hands. This is a course of action it recently followed in passing the Credit CARD Act. Congressional reluctance to regulate some forms of prepaid payment methods may be clear from the narrow definition attributed to "general-use prepaid cards" in the Credit CARD Act.[242] However, Congress may still determine that prepaid debit cards must be regulated, particularly in light of their increasing popularity and attention. Congressional action should come in the form of amending the EFTA's definition of "account." Under this amendment, "account" should include "all methods of holding funds that a consumer has provided, or directed to be provided, for the purpose of funding a card or other payment device similar in function to a debit card."[243] Congress has clearly indicated its concern for the protection of consumers' use of electronic fund transfer system.[244] If Congress takes this

235. *Id.* For example, MasterCard's policy limits protections only to customers who have an account in good standing, "have exercised reasonable care in safeguarding [their] card [against] any unauthorized use," and it does not apply if there are more than two instances of theft or unauthorized use of a card in one year. *MasterCard Zero Liability: Zero Liability Protection for Lost & Stolen Cards*, MASTERCARD.COM, http://www.mastercard.com/us/personal/en/cardholder services/zeroliability.html (last visited Dec. 19, 2009).

236. Martin, *supra* note 72.

237. BRETTON WOODS, INC., PAYMENT SYSTEMS EVOLUTION AND BRANDED PREPAID CARD ANALYSIS © 5 (2009), *available at* http://wenku.baidu.com/view/a4ad971ec5da50e2524d7ff 9.html.

238. *See* FED. RES. BANK OF N.Y., *Stored Value Cards*, *supra* note 8.

239. *See* Furletti, *Prepaid Card Markets*, *supra* note 32, at 14.

240. *See supra* Part IV (discussing current regulatory approaches to regulating the prepaid card industry).

241. Electronic Fund Transfer Act of 1978, 15 U.S.C. 1693(a) (2006).

242. *See* Credit Card Act of 2009, 15 U.S.C.A. § 1693*l*-1(a)(2)(A) (West 2010).

243. Hillebrand, *supra* note 126, at 796.

244. *See* 15 U.S.C. § 1693(a).

action, the Board will be forced, under the EFTA, to comply and issue conforming amendments to Regulation E.

VII. CONCLUSION

The prepaid debit card industry is "at an inflection point."[245] Unfortunately, consumers—particularly the underserved—who purchase such cards as an account substitute remain unaware that this "prepaid product may be distinctly second rate in terms of the clarity, and perhaps the existence, of [] essential consumer protections."[246] As the underserved population multiplies in the current economic crisis and the marketplace for prepaid debit cards continues to reflect this growth, the need for consumer protection resounds even more. In light of the increasing popularity of prepaid debit cards, federal laws and regulations must be extended to protect the nation's most vulnerable consumers.

Ari M. Cohen[*]

245. Flanigan, *supra* note 12 (quoting Mark Troughton, President of Cards and Networks at Green Dot).

246. Hillebrand, *supra* note 126, at 794.

* B.A., University of Michigan, 2005; J.D., Candidate, Brooklyn Law School, 2011; Executive Notes and Comments Editor, Brooklyn Journal of Corporate, Financial & Commercial Law. I am grateful to the members of the Brooklyn Journal of Corporate, Financial & Commercial Law, particularly Robert Marko and Steven Bentsianov for their work on this note. I wish to thank Angie for her support and patience throughout this process and law school. Finally, I wish to thank my parents, Alan and Joni Cohen, for their love, encouragement, and inspiration.