

Prepaid & Emerging Payments Year in Review

*2012: Continued
Regulatory Focus*

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2012



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For legal counsel and advice in:

Prepaid and Stored Value | Mobile and Contactless Payments | Bank Regulatory Compliance | Money Services Business (MSB) Compliance
Electronic Wallets and P2P Payments | Anti-Money Laundering Compliance | Bill Payment, Overdrafts and Lines of Credit | Retail Gift Cards | Abandoned Property
Money Transmitter Licensing | Privacy and Data Security | Patents and Intellectual Property | Litigation Strategy and Defense



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A Broader Perspective™

Agenda

2012 legal developments:

- **Consumer Protection – Judie Rinearson**
 - The Consumer Financial Protection Bureau (CFPB)
 - The Durbin Amendment; Remittance Regulations; Legislative activities
- **Anti-Money Laundering Laws – Kris Andreassen**
 - FinCEN’s Prepaid Access Update – CIP and CDD
 - Prepaid “monetary instrument” Cross-Border Regulation
- **Banking Regulatory Developments – John ReVeal**
 - Restrictions on Third Party Relationships
 - FDIC hostility toward Prepaid and other Credit Products
- **Privacy and Data Security – Linda Odom**
 - Increasing Regulatory concerns
 - Data security and PCI-DSS Compliance
- **Retail and Reward Card Developments – Margo Strahlberg**
 - Consumer Protection & Abandoned Property Legislation
 - Abandoned Property, Consumer Protection & Bankruptcy Litigation

Closing: Your Questions Answered!

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Consumer Protection

Judie Rinearson

CFPB Developments

- Prepaid Field hearings & Ask CFPB about Prepaid Cards
- Advanced Notice of Proposed Rulemaking on GPR (General Purpose Reloadable) cards
 - Reg E; Credit access; Fee Disclosures
- Larger Participant rules
- Complaint collection
- Risky Non-Bank Supervision rules
- Preemption of conflicting state escheat laws
- CFPB enforcement actions
- Consumer Protection Compliance Programs
- Information Request on Campus Card programs; Arbitration
- DC Circuit decision re: Recess Appointments

Durbin Amendment – Hot issue

Routing and Exclusivity

- Applies to **ALL debit and general-use prepaid cards**
- Other “**form factors**”? Mobile phones? Fobs?
 - Routing restrictions still apply
 - Supplemental access device connected with a card - must also comply.
- **Major difficulty:**
 - Open loop gift cards requiring the addition of a PIN network or a second signature network.

Durbin Effective Dates

- Interchange requirements – **October 1, 2011**
- Exclusivity for Payment Networks - **October 1, 2011**
- Routing and Exclusivity generally for issuers - **April 1, 2012**
- Routing and Exclusivity for HSA / FSA / HRA cards (those using transaction substantiation systems) – **April 1, 2013**
- Prepaid Card issuers – generally **April 1, 2013**
 - Non-reloadable sold before **April 1, 2013** exempt
 - For reloadable cards sold and reloaded prior to **April 1, 2013**, the effective date for routing rules is **May 1, 2013**;
 - For reloadable cards sold prior to **April 1, 2013** and reloaded on or **April 1, 2013**, the effective date for routing rules is 30 days after the date of reloading

Remittances

Dodd-Frank Act Section 1073

- "Remittance transfer" is an "electronic ... transfer of funds requested by a sender located in any State to **a designated recipient [in a foreign country]** that is **initiated by a remittance transfer provider ...**"
- Clear and conspicuous disclosures required, in writing and in a form the sender may keep
- Liability protections

Big news: Implementation Delayed beyond Feb 7, 2013

- Over 100 comments received – many seeking 6-12 months delay

Remittance laws impact on both prepaid and emerging payment products.

Legislative Activity

- **CFPB Privilege Bill Enacted.** US H 4014
- **The Gift Card Consumer Protection Act.** U.S. Sen. Richard Blumenthal's (D-Conn.) (2012)
- **The Protect and Save Act of 2013** (US H 295)
- **Senate Subcommittee Prepaid Card Market Hearings**
- **Tax Fraud and Identity Theft Hearing** and GAO report on Tax Fraud; **Treasury IG report** on Tax Fraud
- **FDIC Report on Prepaid vs Debit**



AML Issues

Kris Andreassen

FinCEN's Prepaid Access Rule

- On July 26, 2011, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued ***Final Regulations on Prepaid Access***.
 - Providers and sellers of prepaid access must have effective AML compliance programs; file SARs and CTRs; and collect, verify and retain customer identifying information, among other things.
 - Providers of prepaid access must register as MSBs with FinCEN.
- The Prepaid Access Rule became fully effective on March 31, 2012.

FinCEN's Prepaid Access Rule: Bank-Controlled Programs

- Administrative Ruling (FIN-2013-R003) issued May 23, 2012 on application of the Prepaid Access Rule to bank-controlled prepaid programs.
 - A bank cannot be designated as a provider of prepaid access.
 - “Although a contractual designation of a bank as a ‘provider of prepaid access’ cannot make a bank an MSB, such language in a contract would serve as evidence of a bank’s oversight and control over an arrangement to provide prepaid access.”
 - “Where a bank has primary oversight and control over an arrangement to provide prepaid access, no participant is required to register as the provider of prepaid access.”
 - However, you may still be a **seller** of prepaid access if you sell a covered prepaid product that can be used before verification of customer identification occurs.

FinCEN's Prepaid Access Rule and the Bank CIP Rule: Customer identification and verification

- Prepaid Access Rule requires providers and sellers to obtain identifying information about a person who obtains prepaid access under a prepaid program, and to verify the person's identity.
 - Still an issue for “sellers,” even in a bank-controlled program.
- Bank Customer Identification Program (CIP) rule requires banks to obtain identifying information from each **customer** (i.e., a person who opens a new **account**) and verify the customer identity, enabling the bank to form a reasonable belief that it knows the true identity of each customer.
- ***When does a prepaid product constitute an account?***

FinCEN Customer Due Diligence ANPRM

- In March 2012, FinCEN released an ANPRM seeking comment development of a customer due diligence (CDD) regulation that would:
 - Codify, clarify, consolidate, and strengthen existing CDD regulatory requirements and supervisory expectations, and
 - Establish a categorical requirement for financial institutions to identify beneficial ownership of their accounts, subject to risk-based verification and pursuant to an alternative definition of beneficial ownership.
- Although the federal banking agencies already generally expect appropriate and adequate CDD policies, procedures and processes, FinCEN intends to clarify, consolidate and harmonize the agencies' minimum expectations in this regard.

FinCEN Cross-Border Reporting of “Monetary Instruments”

- Final rule marked as “received” by OMB on Feb. 11, 2013.
- Oct. 2011 NPRM would expand scope of “monetary instrument” reporting requirement at U.S. borders.
 - Would general use prepaid cards, payroll cards, government benefits cards, and store gift cards to the list of other monetary instruments that (together with currency) must be reported at the U.S. border in excess of \$10,000.
 - **“Tangible prepaid access device”** is defined as “any physical item that can be transported, mailed, or shipped into or out of the United States and the use of which is *dedicated to obtaining access to prepaid funds or the value of funds by the possessor in any manner without regard to whom the prepaid access is issued.*”
- NPRM would exclude:
 - Credit cards and debit cards, codes and PINs, and items like computers or Web-enabled cell phones, or other devices that are not dedicated to accessing specific prepaid funds.
 - Cross-border transportation of prepaid cards by businesses shipping inventory to sales agents.

Cross-Border Obstacles/Issues

- Questionable Enforcement
 - Network branded open loop cards can be indistinguishable from credit and debit cards.
 - Unintentionally inaccurate (loads by third parties).
 - How to read available balance?
- Other Considerations
 - Right to Financial Privacy
 - State Privacy Laws
- Bottom Line
 - Ignores existing regulatory framework and safeguards implements by card issuers.
 - ***Is this really effective in stopping cross-border money laundering?***



Banking Regulatory Developments

John ReVeal

Third Party Payment Processors

- Metro Phoenix Bank Consent Order, June 2011
 - Cannot provide processing for TPP Processors or their client entities without comprehensive due diligence on all entities
 - Thorough analysis of any reputational, compliance, legal, fraud, Unlawful Internet Gambling, and BSA risks
 - Formal legal opinion regarding legal, reputational and fraud risk
 - Policies and procedures to address UDAP laws, ACH and remotely created check activities
 - Required to identify and eliminate “nested” TPP Processors
 - Required a 6-month review of all high-risk accounts and high-risk transactions

Third Party Payment Processors

- First Bank of Delaware Consent Order, December 2011
 - The bank “failed to adequately oversee third-party payment processor relationships and related products.”
 - Several TPP Processors allegedly had histories of FTC Act violations
 - Very high return rates for remotely created checks
 - \$15,000,000 civil money penalty (bank had net income of \$1.5 million)
 - Bank stripped of its charter

Third Party Payment Processors

- 1st State Bank (Crossett, AR) Consent Order, January 2012
 - Operating “without effective supervision of third-party risks”
 - BSA issues identified with TPP Processor activities and remote deposit capture
 - Required 2-year BSA look back, by independent 3rd party, for transactions involving TPP Processors
 - Required increased reserves for potential charge-backs and other liabilities

Third Party Payment Processors

- Meridian Bank Consent Order, October 2012
 - No merchant processing services for TPP Processors, TPP Processor merchants, or direct merchants, without:
 - Comprehensive due diligence on all entities
 - Thorough analysis of any reputational, compliance, legal, fraud, Unlawful Internet Gambling, and BSA risks
 - Formal legal opinion regarding legal, reputational and fraud risk
 - Policies and procedures to address UDAP laws and ACH activities
 - Required to identify and eliminate “nested” TPP Processors
 - Required 22-month BSA look back by independent 3rd party
 - Required increased reserves for potential charge-backs and other liabilities

Third Party Payment Processors

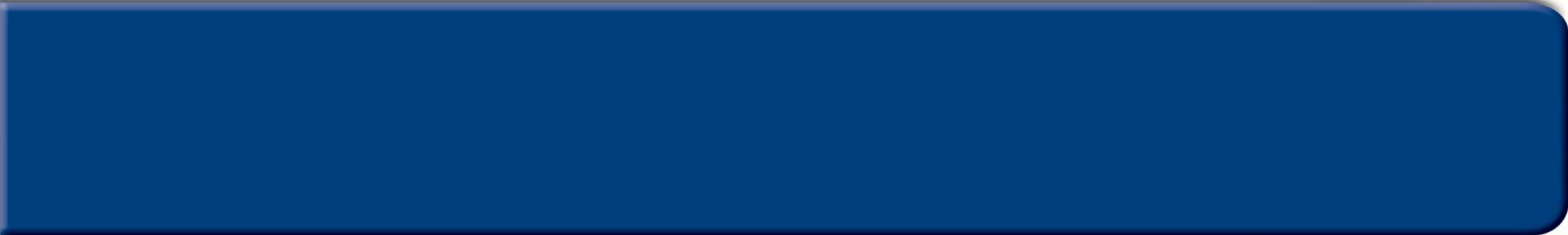
- Other pending actions not yet made public
- See FDIC FIL 3-2012
- Eliminate nested TPP Processors
- Perform independent FTC and BBB complaint reviews
- Do not tolerate high ACH return rates (approaching or exceeding one percent)

Hostility to Prepaid and to Payday and Other Credit

- At least 3 banks have effectively been directed to exit or greatly limit prepaid
 - Particular focus on program manager offerings
 - Aggressive interpretations of UDAP
- Links to payday lending often, but not always, the issue

Hostility to Prepaid and to Payday and Other Credit

- Urban Trust Bank Formal Agreement
 - OCC formally responded to consumer groups to assure them that the OCC would closely monitor the bank’s “deficiencies in its oversight of its third party vendor relationships,” including payday lenders
 - The loans involved were allegedly payday loans disguised as a line of credit or overdraft protection on prepaid cards



Privacy, Data Security and PCI Compliance

Linda Odom

Data Privacy Developments

Key Themes that relate to payments:

- Greater consumer control over data usage
- Protection of children's data privacy
- Mobile Apps
- Social media
- Cloud Computing

Federal Regulatory Efforts

The Consumer Privacy Bill of Rights

The Proposed Mobile Device Privacy Act

FTC:

- Report on Mobile Apps for Children
- COPPA amendments
- Facebook settlement
- other data privacy related actions

FTC on Mobile Privacy

- FTC Mobile Payments Workshop addressed data security and privacy issues (April 26, 2012).
- FTC Workshop **In Short: Advertising & Privacy Disclosures in a Digital World** (May 30, 2012) addressed mobile privacy and advertising regulations.
- FTC Staff Report, **Mobile Privacy Disclosures** Building Trust Through Transparency, was issued earlier this month.

State Regulatory Efforts

- California
 - Requiring mobile app providers to have privacy policies as providers of “online services” subject to CalOPPA
 - Obtaining signatories, including Google, Apple and Facebook, to its “Joint Statement of Principles” regarding data privacy which commits signatories to certain privacy practices
 - “Privacy on the Go: Recommendations for the Mobile Ecosystem” was issued by the California Attorney General in January 2013.
- Connecticut and Vermont
 - Amendments to Data Breach Notification Statute

Data Privacy Developments

- Final Thoughts:
 - Need strong privacy policy that eases regulatory burdens and risks while protecting business needs
 - Allocate responsibilities and liability among vendors
 - Data Breach Response Plans including notifications
 - Cyber Insurance

PCI Compliance – What's new?

- We all know what “PCI compliance” is, sort of. It's . . .
- Does my company need to comply? Do you store, process or transmit cardholder data, esp. the PAN?
- The new MasterCard rule – Level 2 merchants either need their Self Assessment performed by trained personnel or they need to use an outside QSA.

PCI Compliance in Practice

- Non-Compliance with PCI-DSS is still an issue for many banks and merchants
- Some acquiring banks are not as active in policing the PCI compliance of their merchants as they should be
- There should be a partnership between your company and its relevant vendors and your acquiring bank on PCI Compliance issues

New PCI Publications

- PCI Mobile Payments Acceptance Security Guidelines for Developers
- PCI-DSS Risk Assessment Guidelines
- Mobile Payment Security Assessment Fact Sheet

- New this month:
- PCI Mobile Payment Acceptance Security Guidelines for Merchants as End-Users
- PCI-DSS Cloud Computing Guidelines



2012 Developments Impacting Retail & Reward Cards

Margo Strahlberg

Federal Developments

2012 Proposals

- **Blumenthal's Gift Card Consumer Protection Act (US S 3636)**
 - Proposes to amend the CARD Act provisions of the EFTA
 - Bans expiration dates and certain fees
 - Requirements for companies filing for bankruptcy
 - Eliminates the LAP card exemption
- **CFPB's Preemption Proposal**
 - Whether state laws relating to unclaimed gift cards are inconsistent with and preempted by federal law.
 - Most comments supported federal preemption.

Stay tuned for more on these topics in 2013...

State Developments

Consumer Protection Laws

- **Illinois – IL H 4689**
 - New law adds credit slips issued by a store to the definition of “gift certificate.”
 - IL law prohibits expiration dates of less than five years and post-purchase fees on gift certificates.
 - Became effective January 1, 2013.
- **Rhode Island – RI H 7523/RI S 2433**
 - Exempts gift cards & gift certificates given to a nonprofit for fundraising purposes from the expiration date.
 - Card/certificate must clearly state it has been donated for charity purposes and is subject to a clearly defined expiration date (which can’t be less than 1 year from issuance).
 - Became effective July 1, 2012.

State Developments

Consumer Protection Laws

- **Vermont – VT H 730**

- Provides minimum expiration date period for the “paid value” associated with a gift certificate must be 5 years from the later of the date of issuance or last loading.
- Imposes new disclosure requirements on LAP certificates.
- Exempts LAP certificates where no money or other thing of value is given in exchange.
- Gift certificates donated to a charitable organization for fundraising, without any money or other thing of value being given in exchange by the charitable organization, also are exempt, if expiration date is clearly and legibly printed on the front of the certificate
- Became effective May 14, 2012.

State Developments

Abandoned Property Laws

- **Delaware (DE S 258)**
 - Creates VDA program - incentives to voluntarily report abandoned property and amnesty for certain past unpaid amounts.
 - Holders not currently reporting abandoned property or already engaged in claims with the State Escheator are eligible.
 - Became effective July 11, 2012.
- **Iowa Regulation (IA 9813 2011)**
 - Rescinds administrative rules related to unclaimed property and adopts more comprehensive replacement rules.
 - Specifically permits deducting dormancy fees from gift certificates/gift cards under certain circumstances.
 - Became effective Feb. 1, 2012.
- **Michigan (MI H 4563)**
 - Adds B2B exemption.
 - Became effective May 24, 2012.
- **South Dakota (SD H 1270)**
 - Revises dormancy period for gift certificates from 5 years to 3.
 - Became effective July 1, 2012.

State Developments

Abandoned Property Laws

- **New Jersey (NJ S 1928)**

- Extends dormancy period for stored value cards from 2 years to 5 years.
- Revises amount required to be escheated for a GPR card to be the card value on the date card is presumed abandoned.
- Delays provision requiring ZIP code collection until July 1, 2016.
- Repeals the “place of purchase presumption.”
- As of Sept. 1, 2012, requires cash back for balances of \$5 or less for cards other than network branded cards, non-reloadable cards with an initial value of \$5 or less, or merchandise return cards.
- As of Dec. 1, 2012:
 - Prohibits expiration of underlying funds.
 - Prohibits fees other than activation/issuance/purchase fees, reload fees and replacement card fees, provided such fees are disclosed in writing prior to issuance or referenced on the card or card packaging.
- Became effective June 29, 2012, with delayed effective dates for certain provisions.

Escheat Litigation

- **N.J. Retail Merchants Assn. v. Sidamon-Eristoff**
 - Third Circuit upheld the NJ statute's two-year dormancy period, ruling that there was no preemption.
 - Held that retroactive application of the law to stored value cards already sold is not enforceable with respect to cards redeemable solely in goods and services.
 - Ruled against place-of-purchase presumption, finding it directly contradicts the priority scheme established by the Supreme Court in Texas v. New Jersey.
 - Ruled that the law's data collection provision is enforceable and that retaining a purchaser's ZIP code furthers the State's legitimate interest in determining which state has the right to the property.

Subsequent to the court's ruling

- Industry threatens to pull out of NJ; harshly worded State campaign against the industry.
- NJ Governor Chris Christie signs NJ S 1928, which among other things extended dormancy period, delayed ZIP code collection requirements and repealed place of purchase presumption.
- Supreme Court denies New Jersey's petition for a writ of certiorari.

Escheat Litigation

- **Staples Rebate Check Case**

- DE Chancery Court ruled unclaimed “rebate checks” fit within the specifically enumerated property types.
- Court considered only the form of the property, not its purpose.
- Opens the possibility that consumer rebates offered via prepaid cards are subject to escheat.

Consumer Protection & Bankruptcy Litigation

- **Rite Aid Gift Card Settlement**
 - Rite Aid paid \$800,000 settlement in lawsuit alleging false advertising and failure to comply with CA's gift card cash redemption law.
 - Rite Aid agreed to clearly display limitations and all conditions necessary for customers to purchase items for advertised prices.
 - Rite Aid agreed to implement new checkout system to prompt consumers to consider cash redemption when card balances are less than \$10.
- **Voided Abercrombie & Fitch Promotional Gift Cards**
 - Class certification granted against Abercrombie & Fitch in a lawsuit concerning voided holiday gift cards that stated they had no expiration date.
 - Lawsuit will address whether Abercrombie committed breach of contract when it voided the promotional gift.
- **Outstanding Gift Cards in Borders Bankruptcy**
 - Bankruptcy Court rejected request from group of Borders gift card holders to file untimely proofs of claim based on unused amounts remaining on their gift cards.
 - Court ruled gift card holders were not "known" creditors and that they received sufficient notice.

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Questions

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