New regulations and technology will reshape the rules for the prepaid industry in 2016. The Consumer Financial Protection Bureau says it will release new rules in the first quarter. This will likely to have wide-reaching effects on payments in the United States. At the same time, prepaid programs of all types will be affected by the adoption of new technology including EMV and mobile technology.

by Ben Jackson,
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Introduction

As 2016 begins, prepaid providers find themselves in a game where the rules will likely change. The new rules of the prepaid game will be shaped both formally and informally, and the industry will need to be alert and flexible in order to keep up. On one hand, new regulations will have the most obvious effect on the industry. On the other hand, changes in technology will subtly alter the game as well.

Long Awaited Rules Are Expected to Finally Appear

The Consumer Financial Protection Bureau has been working on a set of prepaid rules for more than three years. In May 2012, it issued an Advance Notice of Proposed Rulemaking to gather information about disclosures, unauthorized transactions, and product features.¹

In December 2014, it issued 870 pages of proposed regulations that covered everything from prepaid card disclosure to overdraft to person-to-person payments to (possibly) virtual currency. Note that the entire Durbin Amendment regulations were implemented with only 307 pages.

In defining prepaid cards, the usual suspects like general purpose reloadable (GPR) cards, incentives cards, and even government benefits cards are included. In addition, the CFPB has decided to trawl the ocean to see what it dredges up. The proposed rule defines prepaid in section 1005.2 as follows.²

(i) A prepaid account is a card, code, or other device, not otherwise an account paragraph (b)(1) of this section, which is established primarily for personal, family, or household purposes, and which:

(A) Is either issued on a prepaid basis to a consumer in a specified amount or not issued on a prepaid basis but capable of being loaded with funds thereafter,

(B) Is redeemable upon presentation at multiple, unaffiliated merchants for goods or services, usable at automated teller machines, or usable for person-to-person transfers; and

(C) Is not: (1) a gift certificate defined in § 1005.20(a)(1) and (b); (2) a store gift card as defined in §1005.20(a)(2) and (b), (3) a loyalty, award, or promotional gift card as defined in §1005.20(a)(4) and (b); or (4) a general-use prepaid card as defined in §1005.20(a)(3) and (b) that is both labeled as a gift card or certificate. [Page 714]

Prepaid accounts under this definition include payroll cards and government benefits accounts, but not health savings accounts or flexible spending accounts. Page 715 specifies: “The term ‘prepaid account’ does not include a health savings account, flexible spending account, medical savings account, or a health reimbursement arrangement.”
What also falls under this definition are products like Venmo, PayPal, and Dwolla, which are used for person-to-person (P2P) payments and not typically as a checking account replacement. So, pretty much everything that might store money at any point has been included in the proposed rules.

The proposal would extend Regulation E protections to prepaid products that are cards, codes or other devices capable of being loaded with funds, not otherwise accounts under Regulation E and redeemable upon presentation at multiple, unaffiliated merchants for goods or services, or usable at either automated teller machines or for person-to-person (P2P) transfers; and are not gift cards (or certain other types of limited purpose cards), by bringing these products under the proposed definition of “prepaid account.” [Page 4]

Products like Dwolla can be used at multiple, unaffiliated merchants, and Venmo is a P2P service enabling users to link directly to an account or to store money. This CFPB proposal captures these new products and requires cardlike disclosure for products that do not operate in the same way.

One additional exclusion that exists is cards used for “needs tested benefits” such as Temporary Assistance for Needy Families, Special Supplemental Nutrition Program for Women, Infants, and Children (WIC), and the Supplemental Nutrition Assistance Program. Unlike the Durbin Amendment, the CFPB rules do not give government cards a blanket exemption. The Bureau defines child support and unemployed benefits as non-needs tested, and so it subjects these cards to all the provisions of its rules.

Despite the diversity of the prepaid card business, illustrated in Figure 1, the CFPB believes that for the most part prepaid card types can all be lumped together and subjected to the same rules about all aspects of their business. This ignores the reality that cards issued for an incentives program, say, are much different than those issued to disburse insurance benefits or those designed to be used as a replacement for a checking account. The one-size-fits-all approach is being applied to regulation in such a way that it may cause some financial service providers to reconsider whether they want to be in the open-loop prepaid business or in the prepaid business at all.

The Bureau explains its reasoning as follows.

The Bureau notes that while not all prepaid products can or will be used as transaction account substitutes, the proposed prepaid account definition discussed below appropriately includes a variety of product types that the Bureau believes warrant protection under Regulation E. The Bureau is concerned that to try to carve out very specific types of products that are, or can be, used for short-term limited purposes is complicated and could result in consumer confusion as to what protections might apply to otherwise indistinguishable products. [97]
On November 20, the CFPB said that it expects “to issue the final rule in spring 2016,” in a post on its website. It is not clear why the CFPB is taking so long to digest the comments, nor do we know what direction the Bureau is taking based on those comments. But, we do know that the announcement came after the troubles that RushCard and its customers had. A change in processors led thousands of RushCard holders to lose access to their accounts, some for days and others much longer. While there is nothing about the disruption that was inherent to prepaid cards themselves, the CFPB has launched an investigation into why RushCard wanted to change processors. The concern is that the CFPB will try to somehow regulate away technical glitches that aren’t unique to prepaid cards.

If the rules come out in spring 2016 as proposed, then there will likely be a major disruption to the prepaid card business. Depending on the implementation time frame given for compliance, program managers may need to recall and destroy mountains of cards and marketing materials. It is clear that the CFPB is not the Environmental Protection Agency (given the reams of paper needed to print out its last regs, it might be the EPA’s sworn enemy). All the same, it would be nice to avoid a repeat of the CARD Act, which led to piles of unusable cardstock being landfilled.

Figure 1: Mercator Advisory Group’s Taxonomy of Prepaid Cards: 11 Categories, 26 Market Segments (Potentially Affected Segments Shown in Red)

<table>
<thead>
<tr>
<th>Category</th>
<th>Segments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Access</td>
<td>Travel, Money / Financial Services, Open Gift, Remittance / P2P</td>
</tr>
<tr>
<td>Business Time and Expense</td>
<td>Events and Meetings, Employee/Partner Incentives, Consumer Incentives</td>
</tr>
<tr>
<td>Campus</td>
<td></td>
</tr>
<tr>
<td>Digital Content</td>
<td></td>
</tr>
<tr>
<td>In-Store Gift Cards</td>
<td>In-Store Gift Cards, Store Credits/Returns</td>
</tr>
<tr>
<td>Government</td>
<td>Social Security, Nutritional Assistance, Temporary Assistance for Needy Families (TANF), Court-Ordered Payment, Transit, Tolls, State Unemployment</td>
</tr>
<tr>
<td>Insurance Casualty Claims</td>
<td></td>
</tr>
<tr>
<td>Payroll and Benefits</td>
<td>Payroll, Benefits, FSA / HSA</td>
</tr>
<tr>
<td>Petroleum</td>
<td></td>
</tr>
<tr>
<td>Utilities</td>
<td></td>
</tr>
<tr>
<td>Telecom</td>
<td>Prepaid Mobile Minutes and Data, Prepaid Long Distance</td>
</tr>
</tbody>
</table>

Source: Mercator Advisory Group

The regulations would change the way that prepaid providers present disclosure to potential cardholders. They would also force the cards to comply with Regulation E for functions like those of checking accounts, and with
Regulation Z if they offer any kind of overdraft provision. What complicates this picture is that the rules view any fee charged when there is a negative balance on a card as a credit-like function and thus would force Regulation Z compliance. The problem is that if a prepaid card product charged a standard monthly fee at the same time that a cardholder’s prepaid card balance had been driven negative by technical events like batch processing, floor limits, and forced transactions, then the card product would fall under Regulation Z even though it offered no overdraft provision. It is worth noting that checking accounts, even those that offer overdraft, are not subject to Reg. Z.

Additionally, the rules are still being processed as the CFPB investigates the prepaid outage that happened with UniRush LLC’s RushCard. Processor glitches inevitably happen, so there is concern in the payments card industry that the CFPB might impose regulations on prepaid processor selection and transitions to try to regulate technical glitches that could happen to any card program, whether credit, debit, or prepaid.

Other Regulations Will Also Have an Impact on Prepaid

It is not just federal regulations that will affect prepaid providers. State laws and regulations will continue to affect how and even where the prepaid industry can do business. The most recent example is the payroll card regulations that have been proposed by the New York Department of Labor. The regulators initially proposed rules in May that they revised and reissued in October. The rules would essentially eliminate all forms of fees that a cardholder could be charged in connection with the cards. As is typical in these kinds of regulations, there is no mention of any fees that a checking account customer might face; the CFPB seems concerned only with fees on prepaid cards.

Payroll providers would be left with interchange and perhaps out-of-network ATM fees as their only sources of income. They could charge employers, but employers typically adopt payroll cards as a way to cut costs, not increase them.

In reality, some providers have said that if the regulations go into effect, even in the revised version, they likely will stop offering prepaid cards in New York. If the goal of the state government was to force workers back into using high-cost financial services and cause them to pay fees for every payment they make, then these rules will definitely prevent workers from easily accessing electronic payments.

Regulations are not the only thing that will disrupt the prepaid business. The march of new technology will have its own effects.

EMV and Mobile Payments Will Affect All Types of Prepaid Cards

The first deadline for the liability shift under network rules for EMV chip cards has come and gone. As of this writing, most credit and debit cards in the United States do not have chips on them. Of course, most retailers in the United States are not ready to accept those cards either. So prepaid has a reprieve from dealing with the issues raised by EMV, at least for now. However, this situation will not last forever.
EMV will cause fraud to move from counterfeit cards to card-not-present transactions and to those cards that do not have an EMV chip embedded in them. Prepaid will find itself an increasing target as criminals look for targets of easy opportunity. Since most prepaid cards do not carry large balances, it may be that criminals will shift their attention to online fraud and ignore prepaid cards for the most part. Fraud may shift to non-EMV cards such as prepaid, or it may shift to card-not-present transactions. If the debit and credit card programs have learned from the experiences of other countries that have already made the shift to EMV, then card-not-present fraud may not see the same spike because of better fraud controls being implemented. If that happens, prepaid card providers will need to be more vigilant than ever before for signs that their portfolios are being compromised both online and offline. As the payments industry learns the new rules of fraud prevention, prepaid providers may find they have additional risks that are different from their credit and debit brethren.

Additionally, prepaid card providers may need to explain to consumers who identify chip cards with payment security why they have not yet adopted chip cards and when they plan to do so. As more chip cards come into shoppers’ wallets, the expectation that all cards will have chips is likely to grow.

Mobile payments are the other change that will alter the environment for prepaid card providers. Cardholders will want to use their prepaid cards in mobile wallets such as Android Pay, Apple Pay, and Samsung Pay. Prepaid providers will need to decide where and how they want to participate in these payment schemes, including considering whether they will be willing to give up revenue to include their cards in mobile wallets. By the same token, the rise of alternative mobile payment apps, such as CurrentC, Walmart Pay, and Chase Pay will make the market more competitive.

The world of mobile payments is where closed-loop card providers will have to adapt to new rules. As customers use their mobile devices to store payment credentials, including gift and incentive cards, retailers and other closed-loop issuers will need to be sure that their payments systems can connect with mobile payment devices. Gift cards will be bought, sold, and redeemed through mobile phones. Mobile payments, apps, and wallets offer new opportunities for closed-loop issuers to connect with, market to, and learn about their customers.

However, all the new possibilities offered by mobile payments do not give retailers and other issuers carte blanche to intrude on their customers’ lives. They will need to learn how to fine-tune market messages so they are relevant and timely and do not damage the issuers’ brand by being intrusive or even creepy. No one likes the idea of being tracked and manipulated, but the wrong approach to mobile communication could easily lead to those feelings.

The options created by this new technology are not limited to retailers, banks, and mobile phone companies. Others could make use of these tools as well. For example, transit agencies may be able to reduce their need to create fare media if they can find a way to let commuters pay with their mobile phones. Government agencies distributing benefits may be able to increase identification verification if they can create mobile payments tools to either supplant or supplement the cards that they issue.
Conclusion

The coming year will be one when prepaid providers of all types will need to devote time to learning the new rules of their respective game. The work effort is magnified by the fact that the rules are being made up as the year goes along. Still, payments providers can't just put their businesses on hold while they wait for the rules to be written. Instead they should take a three-pronged approach to the coming year.

1. Gather the best information available about the changes affecting their part of the industry and develop a sound business plan that incorporates those insights. Being aware of the changes will help providers be prepared for both the disruptions and the opportunities they provide.

2. Work to influence the changing environment where possible. Comment on proposed rules, lobby for better laws individually and with trade associations, and work with innovators to create new payments technology.

3. Be flexible as new challenges and opportunities come up. Companies cannot afford to be too set on a path if it leads them over the edge of a cliff. Things will change, and those who are fastest to adapt will be the ones who will flourish in the new environment.

Endnotes


ii For consistency, page numbers on quotes will refer to the version of the rules published as a standalone pdf by the Bureau. A copy can be found at: http://paymentsjournal.com/Download.aspx?id=23673

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