The Consumer Financial Protection Bureau Issues Final Rule to Create Consumer Protections for Prepaid Accounts

October 14, 2016

Introduction and Overview

After an unusually extended four-year rulemaking process, on October 5, 2016, the Consumer Financial Protection Bureau (the "**Bureau**") issued a final rule amending Regulations E and Z to create comprehensive consumer protection measures for prepaid accounts (the "**Rule**").

The Rule provides a rather generous implementation period, and the bulk of the Rule does not take effect until October 1, 2017. [1] The Rule contains more than 1,600 pages of background, summary analysis, commentary, and regulatory text, along with separate model forms and a coverage chart that can be found on the Bureau's website.

In issuing the Rule, the Bureau noted in the Rule's preamble that prepaid accounts "have been among the fastest growing types of payment instruments in the United States," citing studies from the Federal Reserve Board and the Mercator Advisory Group, which showed that there were $9.2 billion prepaid card transactions in 2012 and, in 2014, approximately $594 billion was loaded onto prepaid products. Many consumers using prepaid products are unbanked or underbanked consumers.

However, the Bureau found that prepaid products are marketed and sold in such a way that consumers may purchase and load funds on to a prepaid card before having a full opportunity to review the terms and conditions under which the card was issued.

In short, the rapid growth of the prepaid account industry, coupled with the Bureau's belief that consumers may be unaware of the fees associated with the accounts, appear to be the catalysts for the Rule.

While issuers have nearly a year to implement procedures to comply with the Rule, we expect that many issuers will start tailoring their programs to comply with the Rule in the next few months, particularly the pre-acquisition disclosure requirements discussed below.

In addition, because of the Regulation Z amendments associated with Hybrid Cards, issuers will have to consider whether to continue to provide any overdraft protection on prepaid accounts because of the disclosure requirements and ability-to-repay assessments. Issuers that continue to offer overdraft features will have to be familiar with the fair lending rules under ECOA and Regulation B.

Coverage of Prepaid Account Rule

Under the Rule, a prepaid account is defined to specifically include payroll card accounts, government benefit accounts, and two other types of accounts:

1. An account marketed or labeled as prepaid and redeemable at multiple, unaffiliated merchants for goods and services, or designed for use at ATMs; or

2. An account issued on a prepaid basis in a specified amount or capable of being loaded with funds after issuance, the primary function of which is to conduct transactions with multiple, unaffiliated merchants for goods or services; to conduct transactions at ATMs; or to conduct person-to-person transfers and is not a checking, share draft, or negotiable order of withdrawal account.

By definition, a prepaid account includes a physical card or device, as well as an account that may only be accessed electronically or online through a mobile device/smartphone. Certain prepaid products are not covered by the Rule, including gift certificates, gift cards, and accounts loaded with funds from a health savings account or flexible spending arrangement. A Prepaid Account Coverage Chart is available on the Bureau's website. It will help interested parties determine whether a particular product or account is subject to the Rule.

Substantive Requirements

Pursuant to the Rule, prepaid accounts are generally subject to Regulation E, including some specific requirements for prepaid accounts. In particular, the Rule requires prepaid account issuers to provide consumers with both short- and long-form pre-acquisition disclosures. The Rule also adds new requirements for prepaid accounts, including the requirements for an issuer to post its prepaid account agreements online and submit them to the Bureau.

Short-Form Disclosures

The short-form disclosures must contain information detailed in the Rule (e.g., information about periodic fees, per purchase fees, ATM withdrawal fees, cash reload fees, ATM balance inquiry fees, customer service fees, and inactivity fees) in a specified format. The short-form disclosure must also reflect the number of additional fee types that the consumer could be charged in connection with his account; the two additional fee types that generated the highest revenue for the prepaid account program during the previous 24 months; statements regarding linked overdraft credit features, registration, and FDIC/NCUA insurance; and information on where the consumer can find the long-form disclosure. The Rule provides model short-form disclosure forms.

Long-Form Disclosures

The long-form disclosures must include additional information, such as the prepaid account program's name, information about all fees that may be imposed in connection with the prepaid account, a statement regarding registration and FDIC/NCUA insurance, a statement regarding linked overdraft credit features, the financial institution's contact information, and a statement directing the consumer to the Bureau's website for general information about prepaid accounts in the complaint section of its website. For accounts acquired in retail stores, the long-form disclosure may be made available online or over the phone.

Error Resolution

The Rule extends to prepaid accounts the protections of Regulation E's error resolution procedures and limitations on liability. The Rule also requires an issuer to provide a periodic statement for prepaid accounts. Alternatively, an issue may make account balance information readily available by telephone, provide electronic access to a 12-month electronic account transaction history, and provide a 24-month written account history upon the consumer's request.

Hybrid Prepaid-Credit Cards and Regulation Z Amendments

In addition to providing Regulation E protections for the asset account of prepaid accounts, the Rule expands Regulation's coverage by creating separate protections for prepaid accounts with certain overdraft credit features. [2]

Generally, the Rule imposes burdensome requirements on prepaid accounts that are equipped with an overdraft credit feature, a new concept termed "hybrid prepaid-credit cards" ("**Hybrid Cards**"), which covers a transaction that exceeds the prepaid funds that are available in a consumer's prepaid accounts. Subject to certain exceptions, Hybrid Cards are considered credit card accounts and, as such, are subject to Regulation Z's Subpart B, governing open-end accounts, and Subpart G, governing credit card accounts.

A prepaid account is a Hybrid Card if it can be used to access credit either:

1. By linking the prepaid account to a credit account or separate credit feature offered by the prepaid account issuer [3] and allowing credit to be accessed in the course of a transaction conducted with a prepaid card, to obtain cash, or to conduct P2P transfers; or

2. By allowing the prepaid account to acquire a negative balance.

Generally, the Rule requires companies to structure an overdraft credit feature accessible by a Hybrid Card as a separate credit feature, not as a negative balance to a prepaid account. However, deviating from the Proposed Rule, the Final Rule provides one exception to address force pay transactions and other situations where incidental credit is extended as a negative balance. [4] To take advantage of this limited exception, the prepaid account issuer must have a policy and practice of declining to authorize transactions when the consumer lacks sufficient funds to cover the transaction and does not impose certain credit-related fees on the asset account. In this circumstance, the credit extended is only incidental and will not be considered a line of credit subject to Regulation Z. [5]

Assessment of Ability to Repay Overdraft

The Rule requires prepaid account issuers to wait at least 30 days after the prepaid account is registered before offering to the consumer overdraft credit features that may be accessed on the newly registered prepaid account.

Before linking an overdraft credit feature or increasing a credit line related to a prepaid account, the issuer must ensure that the consumer has the ability to repay any overdraft and must comply with special rules regarding credit extensions to individuals under the age of 21. The ability-to-repay assessment is similar to the underwriting standard for credit card issuers. [6] Many industry participants predict that the expected increase in costs associated with underwriting requirements will effectively eliminate overdraft credit features on prepaid accounts.

The Rule generally requires a Hybrid Card's credit features to be distinct from the consumer's asset account. Furthermore, when a consumer reloads funds into a prepaid account after utilizing the overdraft credit feature, the issuer must obtain the consumer's signed written authorization before applying the reloaded funds to repay the credit extension. Once authorized by the consumer, the Hybrid Card issuer may only automatically deduct prepaid funds once per month to cover the overdraft balance.

Additional Open-End Credit Rules for Hybrid Cards

Hybrid Cards will be treated for Regulation Z purposes as open-end credit, subject to various credit card rules, including the following restrictions:

- **Limitations on Fees and Interest Charges**
  During the first year after a Hybrid Card account is opened, total fees for credit features cannot exceed 25% of the credit limit. Further, the issuer cannot increase the interest rate on an existing balance unless the consumer has missed two consecutive payments. If the issuer chooses to raise the interest rate, it must give the consumer 45 days advance notice (during which time the consumer may cancel the account).

- **Monthly Credit Billing Statements**
  Hybrid Card issuers must give consumers written periodic statements detailing, among other things, overdraft fees, interest rates, amount borrowed, and amount owed. This monthly periodic statement, which is identical to the credit card statement, must be sent to the consumer at least 21 days before the payment due date on the statement. An issuer may not charge a late fee unless the consumer fails to pay his payment within this 21-day grace period. Any late fee charged must be reasonable and proportional to the account violation; no specific amount is provided.

Because the Rule now brings prepaid accounts under Regulation E coverage, issuers must comply with Regulation E's compulsory use provision, which applies to all creditors. Accordingly, issuers are prohibited from requiring consumers to set up preauthorized electronic fund transfers to repay credit extended through overdraft credit features. These credit features are not considered overdraft services under Regulation E. Accordingly, opt-in notices are not required to be sent to consumers for these overdraft credit features (although consumer consent is still required, as discussed above).

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[1] The Rule's requirement for issuers to submit their prepaid account to the Bureaus has a delayed effective date of October 1, 2018.

[2] The Rule both amends the implementing regulations of the Credit CARD Act of 2009 and creates a new provision in Regulation Z, 12 C.F.R. § 1026.61 to cover “hybrid prepaid-credit cards.”

[3] The credit feature is also covered if it is offered by the issuer’s affiliate or business partner.

[4] A typical force pay transaction is a gas pump authorization, where the transaction is initially cleared for a nominal amount that is covered by the balance on the card, but then the payment amount increases when the sale of gas is complete and the account balance falls short.

[5] The company may also structure the negative balance policy and practice to decline to authorize transactions except when the amount of the transaction will not cause the account to be negative by more than $10 (a *de minimis* purchase cushion) or the transaction is conducted when incoming deposits to the prepaid account are pending (a delayed load cushion).

[6] Companies must consider either the consumer’s debt-to-income ratio, debt-to-assets ratio, or residual income after making minimum payments.