Consumer Financial Services Update

The Consumer Financial Protection Bureau Amends Final Prepaid Account Rule and Further Extends Its Effective Date

February 6, 2018

I. Introduction and Overview

On January 25, 2018, the Consumer Financial Protection Bureau (the "Bureau") issued a final rule that amended the Bureau's prior rule governing prepaid accounts (the "2018 Amendments"). Following an unusually extended four-year rulemaking process, in October 2016, the Bureau issued a final rule amending various portions of Regulations E and Z for certain prepaid accounts (the "2016 Prepaid Rule"). The 2016 Prepaid Rule, as amended by the 2018 Amendments, is referenced as the Prepaid Rule.

The Prepaid Rule creates comprehensive consumer protection measures for prepaid accounts, including certain disclosure requirements, dispute resolution requirements, provisions regarding hybrid prepaid-credit card accounts, and a requirement to submit prepaid account agreements to the Bureau. The Prepaid Rule thus imposes a number of significant compliance burdens on prepaid accounts covered by the rule. Among other things, 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.

Notwithstanding the compliance burdens imposed by the Prepaid Rule, the Bureau did address some industry concerns in the 2018 Amendments. Perhaps, most importantly, the Bureau extended the effective date of the Prepaid Rule to April 1, 2019. Moreover, to assist with these compliance burdens, the Bureau has published model forms, disclosure guides, and a coverage chart. In addition, after issuing the 2016 Prepaid Rule, the Bureau had published a Small Entity Compliance Guide, which was updated in July 2017 and which the Bureau has indicated will again be updated to account for the changes made by the 2018 Amendments.

II. Coverage of Prepaid Account Rule

The 2018 Amendments do not significantly alter the coverage of the 2016 Prepaid Rule. As amended, the Prepaid Rule retains the definition of prepaid account, which specifically includes 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 whose primary function is to conduct transactions with multiple, unaffiliated merchants for goods or services, or at ATMs, or to conduct person-to-person transfers.

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 excluded from the definition, including gift certificates, gift cards, and accounts loaded with funds from a health savings account or flexible spending arrangement.

The 2018 Amendments, however, slightly modify the exclusion from the definition of prepaid account for loyalty, award, or promotional gift cards. The 2016 Prepaid Rule generally excluded loyalty, award, or promotional gift cards as currently defined under Regulation E. As amended, the Prepaid Rule will also exempt loyalty, award, or promotional gift cards that are redeemable upon presentation at one or more merchants for goods or services, or usable ATMs, and that are not marketed to the general public. Such cards are not required to satisfy the existing disclosure requirements under Regulation E for loyalty, award, or promotional gift cards in order to be excluded from the definition of prepaid account.

Notably, the Bureau maintains a chart illustrating these coverage criteria, which can be used to help determine if an account is a prepaid account under the Prepaid Rule.

III. Substantive Requirements

Under the Prepaid Rule, prepaid accounts are generally subject to Regulation E, including some specific requirements for prepaid accounts. In particular, the Prepaid Rule requires prepaid account issuers to provide consumers with both short- and long-form pre-acquisition disclosures. The Prepaid 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.

A. Short-Form Disclosures

The short-form disclosures must contain information detailed in the Prepaid 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.

While the 2018 Amendments did not significantly change the short-form disclosure requirements, they did provide an alternative to the part of the disclosure that requires issuers to disclose the two additional fee types that generated the highest revenue. Under the 2018 Amendments, issuers have the option to consolidate the fee variations into two categories and disclose those two categories and the fee amounts. Moreover, the Prepaid Rule does contain model short-form disclosure forms, and the Bureau's website contains a Guide on Preparing the Short-Form Disclosure, which was last updated in April 2017 and which the Bureau intends to update to account for the amendments.

B. 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.

Per the 2018 Amendments, there is now some flexibility in providing the long-form disclosure. Issuers can provide the long-form disclosure electronically without regard to the E-Sign Act's consumer notice and consent requirements and provide the disclosure after acquisition if (1) the financial institution does not provide the long-form disclosure inside the prepaid packaging materials, and (2) the financial institution is not otherwise mailing or delivering to the consumer written account-related communications within 30 days of obtaining the consumer's contact information.

C. Error Resolution and Limitations on Liability

The Prepaid Rule extends to prepaid accounts the protections of Regulation E's error resolution procedures and limitations on liability. The Prepaid Rule also requires an issuer to provide a periodic statement for prepaid accounts. Alternatively, an issuer 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.

As an accommodation to industry, the 2018 Amendments provide an exception for the error resolution and limited liability requirements for unverified prepaid accounts. This exception applies to prepaid accounts that have not concluded the consumer identification and verification process, as long as the financial institution has disclosed the risks of not registering and verifying the account using a form substantially similar to the model notice forms. The exception also applies when the consumer identification and verification process has concluded but the consumer's identity has not been verified and the financial institution has disclosed the risks of not registering and verifying the account using a form substantially similar to the model notice forms. In addition, the exception also covers prepaid accounts that are in programs for which there is no consumer identification and verification process, provided that the financial institution has made the required alternative disclosure for programs with no verification process.

IV. Hybrid Prepaid-Credit Cards and Regulation Z Amendments

In addition to providing Regulation E protections for the asset account of prepaid accounts, the Prepaid Rule expands Regulation's coverage by creating separate protections for prepaid accounts with certain overdraft credit features.[1]

Generally, the Prepaid 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, its affiliate, or its business partner, 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.

1 The Prepaid 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."

In the 2018 Amendments, the Bureau created an exception from the definition of business partner to exclude arrangements between companies that offer traditional credit cards, and companies that offer prepaid accounts when the following conditions are met:

(1) The prepaid account issuer and the card issuer do not allow the prepaid card to draw, transfer, or authorize the draw or transfer of credit from the credit card account without the consumer's signed written request authorizing it;

(2) The prepaid account issuer and the card issuer do not condition the acquisition or retention of either account on whether the consumer authorizes the access described in 1); and

(3) The prepaid account issuer and the card issuer apply the same terms, conditions, features, and fees, whether or not the accounts are linked.

Generally, the Prepaid 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. The Prepaid Rule provides one exception to address force-pay transactions and other situations where incidental credit is extended as a negative balance.[2] 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.[3]

A. Assessment of Ability to Repay Overdraft

The Prepaid 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.[4] Many industry participants predict that the expected increase in costs associated with underwriting requirements will effectively eliminate overdraft credit features on prepaid accounts.

Moreover, the Prepaid 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.

2 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.

3 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).

4 Companies must consider either the consumer's debt-to-income ratio, debt-to-assets ratio, or residual income after making minimum payments.

B. 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 Prepaid 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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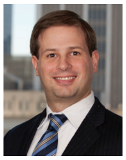
For further information on this topic, please reach out to the authors of this alert or another member of the firm's Consumer Financial Services Group.



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