

FinCEN's Proposed Prepaid Access Rule

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On Monday, June 21, 2010, the Financial Crimes Enforcement Network ("FinCEN") published the Notice of Proposed Rulemaking titled *Amendment to the Bank Secrecy Act Regulations – Definitions and Other Regulations Relating to Prepaid Access* (the "Proposed Prepaid Rule" or "Proposed Rule"). The Proposed Prepaid Rule is mandated by Congress under the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "CARD Act"). The CARD Act directed FinCEN to issue final regulations regarding the sale, issuance, redemption or international transport of stored value, including stored value cards.¹ The Proposed Rule does not apply to depository institutions (i.e. banks) issuing prepaid cards; it applies only to non-bank (1) providers of prepaid access, and (2) sellers of prepaid access.

In sum, the Proposed Prepaid Rule establishes a more comprehensive regulatory framework for "prepaid access" (which replaces the term "stored value") in that it expands the number of parties subject to the BSA and expands the obligations of those parties involved in the distribution of prepaid access. In our view, the additional obligations of the Proposed Prepaid Rule which will present the greatest challenges for the prepaid industry are as follows:

1. The AML Programs of both providers and sellers of prepaid access will need to include a customer identification program ("CIP") such that providers and sellers of prepaid access will have to collect name, date of birth, address and identification number from each person who obtains prepaid access under a prepaid program which is subject to the Proposed Rule. The customer information will need to be verified by the provider and seller of prepaid access and each such entity will have an obligation to keep certain customer records for five years.
2. Certain entities involved in the distribution of open-loop prepaid cards which have thus far been able to avoid registration as a money services business ("MSB") will now be deemed a provider of prepaid access and need to register with FinCEN as an MSB with the commensurate obligations of the same.
3. All providers of prepaid access must file with FinCEN a description of each prepaid program for which it is the provider of prepaid access.
4. Both providers of prepaid access and sellers of prepaid access will be required to make Suspicious Activity Report ("SAR") filings.

All interested parties have until the close of business on July 28, 2010 to submit comments on the Proposed Prepaid Rule to FinCEN. In addition to any comments one may submit with respect to the

Proposed Prepaid Rule generally, FinCEN is specifically soliciting comments to certain questions which we have attached as [Exhibit A](#). Please find below a summary of the Proposed Prepaid Rule.²

Summary of the Proposed Prepaid Rule

Under the Proposed Prepaid Rule, FinCEN proposes to revise the Bank Secrecy Act (“[BSA](#)”) regulations applicable to Money Service Businesses (“[MSBs](#)”) with regard to stored value or, as newly defined, prepaid access. The term “prepaid access” is defined as “an electronic device or vehicle, such as a card, plate, code, number, electronic serial number, mobile identification number, personal identification number, or other instrument that provides a portal to funds or the value of funds that have been paid in advance and can be retrievable and transferable at some point in the future.”³

A. Exclusions

Notwithstanding the broad definition of “prepaid access” above, FinCEN, in the Proposed Rule, excludes five (5) categories of “prepaid access” programs that do not bear characteristics conducive to money laundering or illicit behavior. Any Provider (defined below) of BSA prepaid access programs will be subject to regulation as a “provider of prepaid access” only to the extent the prepaid access programs do not fall within one of the enumerated exclusions.

1. **Payroll Programs.** Programs where the employer (or a designated third party) adds funds to the prepaid card or access device for the payment to direct employees of benefits, incentives, wages or salaries are exempt. This exclusion applies only when (i) the employer (or its agent) and not the employee, can add funds to the card or device, and (ii) when the employer has a direct relationship with the employee (e.g. not where employer works through a third party to pay freelance employees). If the employee is allowed to add non-payroll funds to the payroll card then that payroll card would not fit within this exclusion.
2. **Government Benefit Programs.** Programs where state or federal governmental agencies add funds to the prepaid card or access device for the payment to individuals of government benefits, including unemployment, child support, disability, Social Security, veterans’ benefits, disaster relief assistance and public transit benefits are exempt.
3. **Pre-Tax Flexible Spending Account Programs.** Programs that are pre-funded by employee and/or employer contributions to a pre-tax flexible spending account maintained by a central payor and reimbursed to the employee for health care and dependent care expenses are exempt.
4. **Prepaid Programs Limited to \$1,000 Maximum Funds.** Programs that provide prepaid access to funds subject to limits that include a maximum value are exempt provided that (i) such maximum value is clearly visible on the prepaid access product, (ii) at the point of [initial](#) load, the load limit cannot exceed \$1,000, (iii) at any point in the [lifecycle](#) of the prepaid access, no more than \$1,000 in total maximum value may be accessed, and (iv) on [any given day](#), no more than \$1,000 can be withdrawn with the use of the prepaid access.
5. **Closed Loop Prepaid Programs.** Any programs offering “closed loop prepaid access” are exempt except to the extent they meet one of the two (2) exclusions from this exemption described below.⁴ The term “closed loop prepaid access” is defined as prepaid access to funds or the value of funds that is limited to a defined merchant or location (or set of locations) such as a specific retailer or retail chain, college campus or subway system.⁵

These five (5) exclusions are only available, however, to the extent the prepaid program does not permit: (i) funds or value to be transmitted internationally; (ii) transfers between or among users of prepaid access within a prepaid program (e.g. person-to-person transfers); or (iii) the ability to load monetary value from other non-depository sources onto prepaid access (this latter requirement is inapplicable to closed loop prepaid access).⁶ While (i) and (ii) above appear to be somewhat self-explanatory, subparagraph (iii) above is less clear. We did confirm with FinCEN that subparagraph (iii) is meant to apply to prepaid access cards that may be reloaded via a reload network.⁷ What is less clear is whether subparagraph (iii) is broad enough to apply to every open-loop prepaid card that is initially sold through an entity other than a bank (e.g. a retailer).

B. "Provider of Prepaid Access" Definition

In general, the term "provider of prepaid access" (as used herein, "Provider") will apply to any person that principally "serves in the capacity of oversight and control for a prepaid program" which is determined on a "facts and circumstances" basis.⁸ The various facts and circumstances which FinCEN describes include the following:

- The party who initiates, organizes and establishes the prepaid program (identifying consumer needs, developing business plan, obtaining financing, contracting with other parties, etc.);
- The party who sets the terms and conditions of prepaid program, including the technical specifications involved in establishing and operating the prepaid program (e.g. sales locations, fees, customer service assistance, etc.);
- The party who determines which other parties will participate in the transaction chain (e.g. issuing bank, payment processor, distributor, etc.);
- The party who has the ability to affect the movement of funds and who controls or directs the initiation, freeze or termination of prepaid access; and
- The party who demonstrates control and oversight of transactions, which includes but is not limited to the following:
 - Party whose name in which the prepaid program is marketed to the purchasing public;
 - Party that a "reasonable person" would identify as the principal entity (i.e. subjective standard);
 - Party to whom the issuing bank looks as its "principal representative" in protecting the network relationship and brand integrity;
 - Party who determines distribution methods and sales strategies; and
 - Party whose expertise in the prepaid industry is recognized by other parties in the prepaid program as instrumental in delivering a successful prepaid program.

Providers must comply with certain BSA requirements including (i) the maintenance of an effective AML program, (ii) SAR filings on transactions of at least \$2,000 if the Provider knows, suspects, or has reason to suspect that the transaction involves illegally-derived funds or is intended to conceal

illegally-derived funds as part of a plan to evade federal law, (iii) the establishment of procedures to verify the identity of a customer of a prepaid program and the retention of such customer identifying information, including name, date of birth, address and identification number, for five years, and (iv) the maintenance of transactional records generated in the ordinary course of business by the payment processor or other party that facilitates transaction processing for five years.

In addition, Providers are required to register with FinCEN, identify each prepaid program for which they provide prepaid access, and maintain a list of its agents. Currently, the BSA exempts issuers, sellers and redeemers of stored value from registering with FinCEN and filing SARs; this exemption would be deleted under the Proposed Rule.

Those entities that are excluded from the definition of "Money Service Business" under FinCEN's current regulations are excluded from the definition of "Provider." Accordingly, banks and those entities registered with and regulated or examined by the SEC or the CFTC are not considered Providers of prepaid access under the Proposed Rule.

C. "Seller of Prepaid Access" Definition

Typically, the term "seller of prepaid access" (as used herein, "Seller") is a general purpose retailer, engaged in a full spectrum product line through a business entity such as a pharmacy, convenience store, supermarket, discount store or other retail stores. FinCEN views Sellers of prepaid access as being only second in importance to Providers of prepaid access because the Seller of prepaid access is the party with the most face-to-face contact with the purchaser and, thus, is able to capture information at the point of sale which cannot be done by any other party in the transaction chain.⁹

Sellers must comply with certain BSA requirements including (i) the maintenance of an effective AML program, (ii) SAR reporting on transactions of at least \$2,000 if the Seller knows, suspects, or has reason to suspect that the transaction involves illegally-derived funds or is intended to conceal illegally-derived funds as part of a plan to evade federal law, and (iii) the establishment of procedures to verify the identity of a customer of a prepaid program and the retention of such customer identifying information, including name, date of birth, address and identification, number for five years. Unlike Providers, Sellers are not required to maintain transactional records or register with FinCEN.¹⁰

We anticipate that the obligations placed upon the Seller (notably, the customer identification/verification obligation) and the scope of the exclusions (and the exclusions from the exclusions) will likely generate a significant number of comments from the industry.

The full text of the Proposed Prepaid Rule is available at:
<http://edocket.access.gpo.gov/2010/pdf/2010-15194.pdf>.

Exhibit A**Questions for Public Comment**1. Proposed terminology for this rulemaking

We seek public comment regarding the terms “prepaid access” and “provider of prepaid access,” and whether they offer the best, most meaningful description of the product(s).

2. International transport to be addressed in a subsequent rulemaking

FinCEN intends to undertake a subsequent rulemaking proposal on the international transport of prepaid access. In the interim, we invite comment on any aspect of the international transport issue that we should consider in the context of a future reporting requirement directed at this type of payment mechanism.

3. Alternate approach to designation of a single, central “provider”

The many parties in the transaction chain each bring specialized knowledge to the program. By imposing a separate, stand-alone obligation on each party along the transaction chain, we may facilitate the collection of more detailed information not filtered through any secondary perspective. As FinCEN considers such an alternate approach, we seek comment on which prepaid program participants offer the most meaningful information, such as transaction information, purchaser information, or card holder information.

4. \$1,000 threshold aggregation

In its 2009 MSB NPRM, FinCEN sought comment on whether transactions involving multiple MSB services should require aggregation for purposes of determining whether definitional thresholds had been met. We received industry comments on this issue generally opposed to such a development. FinCEN is still considering the matter and welcomes any further comments on this issue, particularly with respect to the inclusion of the sale of prepaid access in connection with other money services business products.

5. Closed loop prepaid access, generally

We question whether it might now be appropriate to revisit the rationale that we have previously applied to closed loop prepaid access even if such prepaid access is limited solely to domestic use. Are there inherent vulnerabilities in closed loop prepaid access that require our consideration? Is closed loop prepaid access that allows use at more than a single retail facility (for example, at a shopping mall) more vulnerable to abuse than a traditional closed loop product? FinCEN solicits comment on whether and how it should reconsider its existing interpretation with respect to closed loop gift cards.

6. Consideration of examination authority

With respect to providers of prepaid access, FinCEN seeks comment on any particular aspects of the prepaid access sector that should be considered when making a decision about whether and how to delegate examination authority.

7. Future rulemakings contemplated

As noted earlier, we intend to engage in a rulemaking on instituting reporting requirements on the international transport of prepaid access. If there are other areas in need of consideration for future rulemaking, we ask for the public to offer comment.

8. SEC and CFTC-regulated entities; involvement in prepaid access sector

FinCEN is not aware of entities registered with, and regulated or examined by the SEC or CFTC that are actively engaged in the prepaid access industry in such a way as to approach the equivalent of a provider or seller of prepaid access, and solicits comment on the extent to which such entities are engaged in the prepaid access industry.

9. Description of participants in the prepaid access transaction chain

To the degree that our sketch of the landscape is inaccurate or incomplete, we seek guidance and clarification from the commenting public.

10. Employer use of prepaid access program for payroll purposes

We understand that some members of the law enforcement community would prefer to subject all prepaid payroll programs to the full range of BSA obligations. They assert that criminals often establish shell companies and use these fictitious entities and non-existent employees as conduits to launder illicit funds. They believe that the potential for abuse of prepaid payroll cards is considerable and have voiced their concerns to us. We therefore seek public comment regarding the need to institute additional safeguards and/or conditions prior to excluding prepaid access to payroll funds from the full extent of BSA responsibilities. Are there methods to ensure that the company and employees are legitimate, and that the program is valid?

11. Requirements placed on limited value prepaid access to enable exclusion from regulation

We request public comment on the following considerations regarding this section of the proposed rule:

- Please provide us with comments regarding alternative dollar limits, higher or lower than this proposal, daily or otherwise, and tied to a clearly delineated dollar amount or not. What merits are derived and what vulnerabilities are created by increasing or decreasing the threshold? Would an additional activity limit threshold, such as annual multi-thousand thresholds that exist in some European countries, have benefits over our use of a daily dollar level?
- What is the technological feasibility of these requirements? What cost implications and practical burdens are raised by these requirements for the provider of prepaid access, the processor, or any other parties in the transaction chain to enable the application of the exemption?
- What practical implications and what technological challenges arise if different limits are established for transfers, aggregate value, withdrawals, and velocity?

12. Information regarding the prepaid access program to be derived through registration process

FinCEN anticipates that identifying information about the component entities involved in a prepaid program will be fundamentally important to the law enforcement community. We believe that the most efficient way to obtain this information and make it available for law enforcement use is via the registration process, and FinCEN will be considering ways in which the MSB Registration form, FinCEN Form 107, can be updated to accommodate such information. We solicit comments on the use of the form to collect this information.

13. Capture and retention of customer information

FinCEN believes that such customer information capture and retention is necessary for greater financial transparency of the purchasers of the prepaid products or services. We anticipate that retaining such records will assist not only the providers and sellers but may be of great value to law enforcement. FinCEN seeks comment on the value of retaining such records.

14. Mandatory data set of customer information vs. Risk-based assessment of necessary information variables

FinCEN recognizes that verifying and retaining information on every applicable transaction could be time consuming and expensive. Such costs might be alleviated if the precise type of information that an institution had to collect was left to the determination of the provider or seller of prepaid access based on an assessment of their risks, in a manner consistent with other FinCEN regulations. We seek public comment as to the merits of incorporating a risk-based standard into the rule instead of the proposed combination of a risk-based approach with a mandatory set of minimum standards.

15. Certification of regulatory burden

- FinCEN's research has revealed that AML and customer identification requirements are currently imposed on providers of prepaid access (and through them, to sellers of prepaid access) by the partner bank that is authorized to issue the prepaid access by the payment network. FinCEN solicits confirmation of this fact, and any substantial divergence between the current contractual obligations of a provider or seller, and the requirements specified by the proposed rule.
- Please provide comment on any or all of the provisions in the proposed rule with regard to (a) the impact of the provision(s) (including any benefits and costs), if any, in carrying out responsibilities under the proposed rule and (b) what alternatives, if any, FinCEN should consider.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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- ¹ The Proposed Prepaid Rule addresses sale, issuance and redemption of stored value. FinCEN intends to undertake a subsequent rulemaking proposal on the international transport of prepaid access. In the interim, FinCEN invites comment on any aspect of the international transport issue that it should consider in the context of a future rulemaking directed at this type of payment mechanism.
 - ² By way of background, on May 12, 2009, FinCEN proposed a rule identified by RIN 1506-AA97 in which FinCEN requested comment regarding future rulemaking on a revised definition of stored value and otherwise revising related regulations.
 - ³ Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Definitions and Other Regulations Relating to Prepaid Access, 75 Fed. Reg. 36589 (proposed June 28, 2010)(to be codified at 31 C.F.R. 103).
 - ⁴ In our discussions with FinCEN recently, they are describing the Proposed Prepaid Rule approach to closed loop prepaid programs as “In-Out-In.” To explain, the term “prepaid access” is defined broadly so as to initially cover closed loop prepaid programs (i.e. closed loop prepaid access is “in”). However, all closed loop prepaid programs are then excluded from the Proposed Prepaid Rule (i.e. they are out) unless they meet one of the exclusions from the exemptions (i.e. they are back in).
 - ⁵ Amendment to the Bank Secrecy Act, 75 Fed. Reg. at 36,607 (to be codified at 31 CFR 103.11(uu)(4)(ii)(A)(1)-(5)).
 - ⁶ Amendment to the Bank Secrecy Act, 75 Fed. Reg. at 36,608 (to be codified at 31 CFR 103.11(uu)(4)(ii)(B)).
 - ⁷ Thus, if a prepaid access card can be reloaded via non-depository sources it will be subject to the Proposed Prepaid Rule and the Provider and Seller of that prepaid access card will have to collect the cardholder’s name, address, date of birth and identification number.
 - ⁸ Amendment to the Bank Secrecy Act, 75 Fed. Reg. at 36,607 (to be codified at 31 CFR 103.11(uu)(4)(i)).
 - ⁹ Amendment to the Bank Secrecy Act, 75 Fed. Reg. at 36,600.
 - ¹⁰ We note that the rule and comments support this claim although there is one comment that insinuates Sellers do have transactional record retention requirements. *Id* at 36, 605.