

The Consumer Financial Protection Bureau's ("CFPB") proposed prepaid financial products rule ("Proposed Rule"),¹ if adopted without change, would impose sweeping new requirements on issuers of prepaid products—that is, physical cards, apps, and other electronic devices that a consumer or a third party loads with funds to make payments, transfer money, and access cash at automated teller machines ("ATMs").

Comments on the Proposed Rule are due to the CFPB by March 23, 2015. This *Commentary* describes key features of the Proposed Rule and serves as a reminder to those seeking to weigh in before the CFPB's comment deadline.

The Proposed Rule would apply existing credit and debit card protections to prepaid financial products and require “Know Before You Owe” disclosures. It would also add new consumer protections for any extension of credit associated with prepaid products, including overdraft services, such as limits on fees and on automatic debits from linked or associated accounts used to pay loans or overdrafts. The Proposed Rule also would likely increase compliance costs for issuers of prepaid products. These costs may ultimately be passed on to the consumers who use prepaid products, a significant percentage of which are underbanked or do not have bank accounts at all.⁴

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would apply the federal consumer protections in Regulation E, which implements the Electronic Fund Transfer Act (“EFTA”), and Regulation Z, which implements the Truth in Lending Act (“TILA”), to issuers of prepaid products by requiring:

- “Know Before You Owe” disclosures: Standardized short-form and long-form disclosures that describe the terms, conditions, and fees of the prepaid product,
- Protection against fraud: Error resolution and limited liability protections,
- Access to transaction history: Consumer access to 18 months of transaction history,
- Wider availability of account agreements: Posting of account agreements on issuers’ websites and providing account agreements to the CFPB for posting to its website, and
- Underwriting and disclosure protections: Extending Regulation Z’s credit card protections to prepaid products with overdraft services.

The Proposed Rule would establish a new definition of “prepaid account” within Regulation E that covers prepaid debit cards, payroll cards, certain government benefit cards, student financial aid disbursement cards, tax refund cards, peer-to-peer payment products, and other mobile and electronic prepaid accounts. For the first time, prepaid card holders will be guaranteed the same protections and disclosures as those holding credit cards. Gift cards, rebate cards, health spending account cards, and needs-tested state or local electronic benefit transfer card programs are expressly excluded from the scope of the Proposed Rule.

“Know Before You Owe” Disclosures. The CFPB is concerned that prevailing disclosures for prepaid products vary widely among prepaid product issuers and can be difficult for consumers to understand.⁵ To address these concerns, the Proposed Rule would require prepaid-product issuers to provide consumers with both a short-form and a long-form disclosure statement before a consumer purchases a prepaid product or account.

The Proposed Rule includes model short-form and long-form disclosures, similar to those under TILA, that would establish a safe harbor of compliance if used as a prepaid product

issuers’ short-form disclosure statement. Accordingly, for most prepaid product issuers, compliance with the requirements of the long-form disclosure statement will be an important focus.

Short-Form Disclosure Statement. On the short-form disclosure statement, the prepaid product issuer would be required to provide a summary of key information, including a number of different fees:

- Per-purchase transaction fees,
- Monthly or annual fees,
- ATM withdrawal costs,
- Costs to reload the card,
- ATM balance inquiry fees,
- Customer service fees,
- Inactivity fees,
- The highest possible fee that the consumer could incur for any variable rate fees (along with an asterisk to indicate that a lower fee might apply and an explanation of when that might occur), and
- Up to three “incidence-based fees,” which are the fees that consumers of that particular prepaid product have incurred most frequently in the prior 12-month period.

Prepaid product issuers likely have not tracked “incidence-based fees” and will need to examine their products closely to determine what fees are covered in order to comply with this requirement if adopted as proposed.

The short-form disclosure statement would be required to indicate whether credit features, such as overdraft services, are available and what fees apply. If no credit features are offered, then a statement that no such fees will apply would be required.

Additional proposed disclosures on the short-form disclosure statement include:

- A statement regarding the number of applicable fees listed in the long-form disclosure statement,
- A statement that the consumer must register the prepaid account in order to receive liability protections,

- A statement that the product is not eligible for federal deposit insurance coverage,
- The phone number and website address where a consumer can access the long-form disclosure statement, and
- The CFPB's website address.

Long-Form Disclosure Statement. The long-form disclosure statement would disclose greater information about the prepaid product. The Proposed Rule requires prepaid product issuers to disclose on the long-form disclosure statement (i) all fees the consumer could incur along with the conditions under which each fee may be imposed, waived, or reduced, and (ii) whether any third-party fees may be imposed and the amounts of those fees, if known.

The Proposed Rule requires the long-form disclosure statement to contain many of the same statements required for the short-form disclosure statement, plus standard credit card disclosures if the prepaid product issuer offers a credit service, such as overdraft protection, in connection with the prepaid product. The prepaid product issuer would be required to disclose the applicable rates and fees that are presently required for credit cards in a so-called "Schumer Box," an easy-to-read table or box that discloses the rates, fees, terms, and conditions of a credit card agreement as required under TILA. The disclosures in a Schumer Box include:

- Annual fee, if applicable,
- Annual percentage rate ("APR") for purchases,
- Other APRs (balance transfer, cash advances, default APRs),
- Grace period,
- Finance calculation method, and
- Other transaction fees (balance transfers, late payments, exceeding credit limit fee, cash advances).

Application of Credit and Debit Card Protections to Prepaid Products. The CFPB believes that many consumers use prepaid products as an alternative to traditional checking accounts⁶ and so has designed the Proposed Rule to better align consumer protections for both types of products.

The Proposed Rule applies to issuers of prepaid products many of the requirements of Regulation E that currently apply to insured depository institutions that offer checking accounts with debit card access. For example, consumers

who promptly report lost or stolen prepaid cards or other fraudulent activity on their account would be responsible only for a maximum of \$50 of any associated loss.

The Proposed Rule would also require issuers to investigate and timely resolve certain consumer complaints, such as erroneous double charges. For complaints that cannot be resolved within 10 business days after receiving the customer's oral or written notice of the error, prepaid product issuers would be required to make the disputed funds available to the consumer while the investigation is ongoing. However, the Proposed Rule does not address the consequences to the prepaid product issuer if the institution determines that no error occurred and the disputed funds have already been spent.

The Proposed Rule would also require prepaid product issuers to either provide periodic account statements or make account information free and accessible online. Prepaid product issuers would be required to post their product agreements on their websites and provide those agreements to the CFPB for publication on the CFPB's website. The Proposed Rule would revise foreign language disclosures for prepaid products. Where a prepaid product issuer uses a foreign language on prepaid account packaging material, by telephone, in person, or on its website, short-form and long-form disclosure statements must be provided in the same foreign language.

Characterizing Overdrafts as Credit. Some prepaid cards offer overdraft protection to allow purchases, transfers, and withdrawals by consumers who have insufficient funds on the card to cover the transaction. Overdrafts are typically for small amounts of credit, and the consumer pays a flat fee established by the prepaid card issuer and an interest rate for the period that the advance is outstanding. Of the small percentage of prepaid card issuers that offer overdraft services on prepaid products, many of these issuers generally charge the consumer a fee of \$15 per transaction regardless of the amount of credit extended.

Some groups have recommended to the CFPB that prepaid product issuers be prohibited from offering overdraft services altogether due to the amount of fees, interest, and other charges, as well as concerns regarding consumer understanding of these services. In response to these concerns,

rather than prohibiting these overdraft services entirely, the Proposed Rule treats prepaid card overdrafts as extensions of credit and applies new standards, including an evaluation of the consumer's ability to repay, a waiting period between overdrafts, additional disclosures, and other conditions.

The CFPB believes prepaid products that provide overdraft services, overdraft lines of credit, or other similar features generally meet the regulatory definition of "credit card" and, absent an exemption, would therefore be subject to the card rules in Regulation Z. For this reason, the Proposed Rule would extend credit-related underwriting rules to prepaid cards that have overdraft features.⁷

The CFPB's treatment of overdraft services as credit is a departure from the existing rules that were adopted by the Board of Governors of the Federal Reserve Board and transferred to the CFPB following its creation. The existing rules exempt overdraft services from regulation under TILA and Regulation Z with respect to deposit accounts, as long as the financial institution is not obligated to cover any particular transaction. In most instances, a consumer can only spend the funds that are loaded onto a prepaid card, so this exemption will continue to apply to the majority of prepaid cards. The small percentage of prepaid card issuers that offer overdraft services would be required to comply with the card provisions found in TILA and the Credit Card Accountability Responsibility and Disclosure Act of 2009 ("CARD Act")⁸ and implemented through Regulation Z.

The Proposed Rule would prohibit a prepaid product issuer from opening an account or increasing a line of credit associated with a prepaid product unless the issuer has considered the consumer's ability to repay the extension of credit, in the same way that Regulation Z currently requires issuers of credit cards to consider a consumer's ability to make the required minimum payments under the terms of the account based on the consumer's income or assets and the consumer's current obligations.

Prepaid card issuers will be required to establish and maintain reasonable written policies and procedures to consider the consumer's ability to pay, including the following:

- Treatment of any income and assets to which the consumer has a reasonable expectation of access as the consumer's income or assets, or limiting consideration of the consumer's income or assets to the consumer's independent income and assets; and
- Consideration of at least one of the following: (i) the ratio of debt obligations to income; (ii) the ratio of debt obligations to assets; or (iii) the income the consumer will have after paying debt obligations.

The Proposed Rule would allow a prepaid product issuer to add a credit card feature such as overdraft services to a previously issued prepaid card only upon the consumer's specific request and only after a 30-day waiting period from the date of initial registration of the card. Prepaid card issuers may solicit or send an application for a credit feature to the prepaid card holder only after the 30-day waiting period. Once these services are added, the proposal would require issuers to provide consumers a periodic statement indicating the balance, interest, and fees owed not more often than once per month. Prepaid product issuers would also be required to give consumers a minimum of 21 days to repay their debt before imposing a late fee.

The amount that could be charged for late fees, over-the-limit fees, or any other penalty fee or charge would be limited under the Proposed Rule. Generally, under TILA, these fees must be "reasonable and proportional" to the violation of account terms. TILA also provides that a card issuer must not impose a fee for violating the terms of a credit card account unless the dollar amount of the fee: (i) is consistent with either the cost analysis set forth in TILA or the safe harbors set forth in TILA and (ii) does not exceed the dollar amount associated with the violation.

The Proposed Rule provides that a prepaid card issuer may not impose a fee for violating the terms of a credit card account when there is no dollar amount associated with the violation, which would effectively prohibit fees for (i) transactions the card issuer declines to authorize; (ii) account inactivity; and (iii) closure or termination of an account. It is possible the CFPB will establish a penalty fee amount that is presumed to be reasonable and proportional to the omission

or violation to which the fee or charge relates by borrowing from those already established for credit cards or otherwise.

During the first year the account is open, the prepaid product issuer would be prohibited from charging the cardholder total fees of more than 25 percent of the credit limit. Additionally, prepaid product issuers would not be permitted to increase the interest rate unless the cardholder has missed two consecutive payments.

Prepaid card issuers would also be required to give the consumer 45 days advance notice before prospectively increasing interest rates on new purchases. Under the Proposed Rule, prepaid issuers would be required to obtain a consumer's written preauthorization before deducting amounts owed in connection with credit services from a prepaid account. Even with that preauthorization, issuers would be limited to once per month in making such deductions.

The Proposed Rule Signals that Other Short-Term Credit Could Be Subject to Regulation Consistent with TILA and the CARD Act

While the Proposed Rule on prepaid products does not expressly cover other forms of short-term consumer credit, by proposing to designate prepaid accounts with overdraft services or fee-for-credit features as "credit cards" subject to TILA and the Card Act, the CFPB appears to be foreshadowing the direction of a forthcoming rulemaking on checking account overdrafts and possibly the direction of rulemaking on other short-term consumer credit products offered by companies that are subject to the CFPB's jurisdiction.

Checking account overdraft programs are prevalent: an FDIC study of bank overdraft programs found that almost 90 percent of FDIC-supervised banks operated some form of overdraft program.⁹ In recent years, checking account overdraft programs have come under an increasing level of scrutiny by regulators and consumer advocacy groups, and increasingly they are becoming a focus of litigation.

The CFPB has been reviewing the terms of checking account overdraft programs. In June 2013, the CFPB issued a white paper, "CFPB Study of Overdraft Programs, a White Paper of

Initial Data Findings." The white paper highlighted a number of the CFPB's consumer protection concerns with respect to overdraft services based on supervisory data from a small set of large banks supervised by the CFPB, supplemented by responses to a CFPB Request for Information and a recent study conducted by the Independent Community Bankers of America.¹⁰ In broad terms, the CFPB study found that overdraft practices and the rates at which consumers provide consent to charging fees for allowing overdrafts on ATM withdrawals and most debit card transactions vary across insured depository institutions.

More recently, in July 2014, the CFPB published a report, "Data Point: Checking Account Overdrafts," based on data from the same sources as the June 2013 white paper. The report found that debit card issuers have been charging high fees on small overdraft amounts and also that small and medium-sized banks are more reliant on overdraft fees as part of their revenue stream.¹¹ The CFPB has indicated in its most recent Semiannual Regulatory Agenda that the agency plans to conduct further study of overdraft programs and the effects on consumers as it considers whether overdraft rules are warranted and, if so, what types of rules would be appropriate. The CFPB anticipates additional activities regarding overdrafts will occur in July 2015.¹²

Should the CFPB pursue rulemaking for checking account overdraft programs that adopts a model comparable to that proposed for prepaid cards, the result on consumers will likely be widespread. Increased underwriting obligations, disclosures, waiting periods, and caps on fees that will likely flow from a rule that purports to classify checking account overdrafts as credit is likely to disproportionately impact small and medium-sized banks, resulting in increased maintenance fees, higher balances for customers to obtain and maintain free checking, or the elimination of free checking entirely in order to effectively comply with regulations. The CFPB's consumer protection efforts may drive more consumers out of the mainstream banking system and into less traditional financing for low-dollar, short-term loans. More consumers may use prepaid cards and other less traditional forms of short-term financing if the CFPB extends the "overdraft as credit" standards to checking accounts.

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Endnotes

- 1 Consumer Financial Protection Bureau, *Prepaid Accounts under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z)*, 79 Fed. Reg. 77101 (Dec. 23, 2014) (to be codified at 12 C.F.R. pt. 1005, 12 C.F.R. pt. 1026), available at: <https://www.federalregister.gov/articles/2014/12/23/2014-27286/prepaid-accounts-under-the-electronic-fund-transfer-act-regulation-e-and-the-truth-in-lending-act>.
- 2 See Consumer Financial Protection Bureau, *Agency Rule List—Fall 2014*, available at: <http://www.reginfo.gov>.
- 3 Currently, Regulation Z excludes overdraft lines of credit from the definition of “credit card account under an open-end (not home-secured) consumer credit plan credit card.” See 12 C.F.R. § 1026.2(a)(15)(ii)(B).
- 4 According to a 2013 survey by the Federal Deposit Insurance Corporation (“FDIC”), only about 8% of all U.S. households use prepaid cards, although 22% of these households do not have bank accounts. Federal Deposit Insurance Corporation, *2013 FDIC National Survey of Unbanked and Underbanked Households* at 7 (Oct. 2014), available at: <https://www.fdic.gov/householdsurvey/2013report.pdf>.
- 5 Richard Cordray, Prepared Remarks of CFPB Director Richard Cordray at the Prepaid Products Field Hearing (Nov. 13, 2014), available at: <http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-prepaid-products-field-hearing/>.
- 6 See CFPB Proposes Strong Federal Protections for Prepaid Products (Nov. 13, 2014), available at: <http://www.consumerfinance.gov/newsroom/cfpb-proposes-strong-federal-protections-for-prepaid-products/>; see also Preamble to the Proposed Rule—*Prepaid Accounts under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z)*, at 17 (Nov. 13, 2014), available at: http://files.consumerfinance.gov/f/201411_cfpb_regulations_prepaid-nprm_preamble.pdf (relying upon study data from The Pew Charitable Trusts, *Why Americans Use Prepaid Cards: A Survey of Cardholders’ Motivations and Views*, at 7 (Feb. 2014), and 2013 FDIC National Survey of Unbanked and Underbanked Households (Oct. 2014)). The CFPB believes that some consumers have migrated to prepaid cards in response to an inability to maintain a checking account due to increased fees or a history of numerous overdrafts.
- 7 The Proposed Rule defines “overdraft services” as “a line of credit or credit plan subject to Regulation Z, including transfers from a credit card account, home equity line of credit, overdraft line of credit or a credit plan that is accessed by an access device for a prepaid account where the access device is a credit card under Regulation Z.” Consumer Financial Protection Bureau, *Prepaid Accounts under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z)*, 79 Fed. Reg. 77101, 77299 (Dec. 23, 2014) (to be codified at 12 C.F.R. pt. 1005, 12 C.F.R. pt. 1026), available at: <https://www.federalregister.gov/articles/2014/12/23/2014-27286/prepaid-accounts-under-the-electronic-fund-transfer-act-regulation-e-and-the-truth-in-lending-act>.

- 8 Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub.L. No. 111-24, § 2., 123 Stat. 1734.
- 9 Of the 462 FDIC-supervised banks studied, the FDIC found that 86% of them operated some form of an overdraft program. FDIC Study of Bank Overdraft Programs at 5 (2008), available at http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf.
- 10 CFPB Study of Overdraft Programs, *A White Paper of Initial Data Findings*, June 2013, available at: http://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf.
- 11 See G. Michael Flores and T. Zywicki, *Commentary: CFPB Report, Data Point: Checking Account Overdraft* at 4, September 2014, available at: <http://papers.ssrn.com>.
- 12 See Consumer Financial Protection Bureau, *Agency Rule List—Fall 2014*, RIN 3170-AA42 (Overdrafts), available at: <http://www.reginfo.gov>.