

# Non-Credit Card Products: Update on BSA/AML, Treasury Rules, and Unclaimed Property

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# Non-Credit Card Products

- Developments in Anti-Money Laundering Regulation

# Prepaid BSA/AML Landscape

- BSA/AML compliance already complex due to # of products and # of players:
  - Products: General Purpose (Open, Reloadable, Branded); Rebate or Refunds (Tax); Loyalty / Rewards; Gift; Government Benefits; Payroll; Flexible Spending Accounts
  - Players: Program Sponsor / Provider; Card Brand (Network); Cardholder; Retailer / Distributor; Issuer; Processor; Program Manager; Third-Party Agents

# Current BSA Regulations

- BSA Regulations for “Stored Value” (31 CFR ch. X)
  - “Funds or monetary value represented in digital electronics format (whether or not specially encrypted) and stored or capable of storage on electronic media in such a way as to be retrievable and transferable electronically.”
- “Stored Value” exempt from certain BSA Regulations applicable to a “Money Services Business” (MSB):
  - Registration with FinCEN
  - Suspicious Activity Reports

# Current Rules on Customer Verification

- Rule for Banks – Upon creation of a new “formal banking relationship”, bank must follow its Customer Identification Program:
  - Includes deposit, transaction/asset, or credit account, but not check-cashing, wire transfer or check or money order
  - CIP requires verification and retention of customer information (minimum: name, birth date, address, SSN/TIN)
- Rules for MSBs – Risk-based requirement to “verify[] customer identification” unless:
  - Transactions over \$3K – must verify and record name, address, name of ID document, SSN/TIN for other than “established customers”
  - Certain transactions  $\geq$  \$2K (other than “stored value,” SAR with “critical” data) and all  $>$ \$10K (all businesses, CTR)

# Proposed Rule on “Prepaid Access”

- In June 2010, FinCEN released proposal to eliminate “stored value” and create two new categories of MSBs called “providers” and “sellers” of “prepaid access”:

“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”

75 Fed. Reg. 36589, June 28, 2010

# “Prepaid Access” Proposed Rule

- Provider is any person with “principal oversight and control” over a “prepaid program”
- Seller is a “person that receives funds” in connection with a prepaid program (*i.e.*, the retailer with primary face-to-face interaction with the customer)
- Prepaid program is “an arrangement under which one or more persons acting together provide(s) a particular form of prepaid access”
  - Exemptions for domestic non-P2P closed loop, payroll, <1K

# “Prepaid Access” Proposed Rule

- **Five major effects on “prepaid programs”**
  1. Providers and sellers must verify customer identity using stipulated information and retain for five years
    - Minimum information: name, birth date, address, SSN/TIN
  2. Providers (only) must retain transaction information for five years
  3. Providers and sellers must file SARs
  4. Providers (only) must register as MSBs
  5. Providers and sellers must maintain AML programs

# Non-Credit Card Products

- Treasury Moves to All Electronic Payments

# New Treasury Prepaid Card Rules

- In Dec. 2010, Treasury released two rules facilitating Federal payments to prepaid cards.
- 1. Prepaid Card Rule allows “Federal payments” to qualifying prepaid accounts
  - “Federal payment” includes wages, salary, pension, benefits, vendor/expense reimbursement
  - “Prepaid card” defined as “card, code or other means of access to funds”

# New Treasury Prepaid Card Rules

- Prepaid card must meet FOUR conditions:
  1. Issuer must comply with Regulation E (by law or “voluntarily”)
    - Issuer is “any person or entity that issues a prepaid card”
  2. Account must be held at financial institution
    - Rule imposes liability on issuer as well as financial institution that holds account for or on behalf of issuer
  3. Must qualify for pass-through deposit or share insurance (FDIC, NCUSIF)
  4. Account must not be attached to line of credit or loan agreement where repayment to loan is triggered by deposit

75 Fed. Reg. 80335, Dec. 22, 2010

# New Treasury Prepaid Card Rules

2. Non-Tax Payments Must be Electronic - eliminates paper check option for most Federal payments
  - After May 1, 2011 (after March 1, 2013 for individuals already receiving paper checks by May 1, 2011), payees must elect:
    - Direct deposit to bank account, or
    - Direct Express® Debit MasterCard® card (default if direct deposit not selected)
  - Exceptions/waivers still apply (e.g., payments not eligible for deposit to Direct Express card account; hardship)

75 Fed. Reg. 80315, Dec. 22, 2010

# Non-Credit Card Products

- Developments in Unclaimed Property Laws

# Backdrop: Inconsistent Treatment of Prepaid Products

- Many unclaimed property laws do not specifically address prepaid cards
- The 1981 Uniform Unclaimed Property Act added “gift certificates” to the list of intangible property items but failed to define the term
- 1995 updates to the Uniform Unclaimed Property Act provided little clarity
- Applying broad statutory definitions to specific products can therefore be difficult

# Examples of Treatment of Prepaid Products

- By category: “gift certificates” and “gift cards”
  - Indiana: “This Chapter does not apply to gift certificates or gift cards.”
  - Maryland: “Personal property does not include a gift certificate”
- By characteristic: “expiration date” or “network branded”
  - California: “applies to any gift certificate that has an expiration date...”
  - Florida: “an unredeemed gift certificate or credit memo ... is not required to be reported as unclaimed property...” unless it is “sold or issued by a financial institution ... [and] redeemable by multiple unaffiliated merchants.”

# More Backdrop: Priority Rules

- Supreme Court established priority among state claims: *Texas v. New Jersey* (1965), *Pennsylvania v. New York* (1972), and *Delaware v. New York* (1993)
  - Decisions rooted in 14<sup>th</sup> Amendment Due Process principle that prevents multiple states from claiming right to same property
- First Priority Rule: State of last known address of property *owner* may take custody if the property is subject to escheat
- Second Priority Rule: State where property *holder* is domiciled may take custody of the property if owner's address is unknown or in a state that does not provide for escheat

# The Third Priority Rule—Efforts to Expand Rules of Priority

- Third Priority Rule: State where transaction took place may take possession of property if:
  - Owner's address is not known or is located in state that does not provide for escheat of property, *AND*
  - Holder is domiciled in state that does not provide for escheat
- “Deemed Address” provisions
  - Texas: “If the [card issuer] does not obtain the name and address of the apparent owner ... the address ... is considered to be the Austin, Texas, address of the comptroller.”
  - Nevada: “the address of the owner ... shall be deemed to be the address of the Office of the State Treasurer in Carson City.”

# New Jersey's Approach

- In 2010 New Jersey adopted an approach similar to Texas and Nevada but that also requires obtaining name and address:
  - “An issuer of a stored value card shall obtain the name and address of the purchaser or owner [and] maintain a record of the zip code of the owner or purchaser.”
  - “If the issuer ... does not have the name and address ... the address of the owner or purchaser ... shall assume the address of the place where the [card] was purchased or issued...”

# Litigation Challenging New Jersey's Statute

- Plaintiffs raised constitutional challenges and sought injunction of the place-of-purchase presumption
- Federal District Court enjoined:
  - The application of the Third Priority Rule, holding that the statute violated the Second Priority Rule; and
  - The requirement to pay full value to NJ (including profit), which violated the Contracts Clause of the Constitution
  - BUT: declined to enjoin the data collection requirement, which was appealed to the Third Circuit
- Third Circuit Court of Appeals enjoined:
  - The purchaser zip-code data collection requirement

# Other Compliance Issues for Prepaid Products

- Merchant Gift Card Model (closed loop): Issuing subsidiary in a non-escheat state -- 2nd priority rule applies, no escheatment
- Bank Model (open loop): Even for anonymous cards, may escheat to place of purchase – 50 state escheatment
- CARD Act (12 CFR 205.20): Certain prepaid products may not include expiration periods shorter than 5 years. If state dormancy period is shorter, holder subject both to escheat and redemption by the cardholder
- Compliance is difficult due to ambiguity in definitions of covered property and because laws lag behind the marketplace

# Rebates: Fitzgerald v. Young America Corp.

- Young America Corporation processes rebate checks for merchants like T-Mobile, Walgreens, and Sprint.
- At issue in Iowa litigation started in 2006 is whether there can be multiple *holders* of uncashed checks. Is actual possession required to be a “holder”?
  - Iowa Court said it is not clear, denied merchants’ motion for summary judgment
- Walgreens and T-Mobile settled in 2009, and Sprint settled with 36 states in February 2010, for \$22 million
- Similar case now pending between Costco and Washington State over \$3 million in rebates Costco says are held by its third party processor

# Voluntary Compliance Under Delaware Law

- Holders that voluntarily comply are released from claims, demands, interest, and other penalties for noncompliance
- Procedure
  - File Disclosure and Notice of Intent to Comply
  - Complete review of books to identify reportable property
  - Remit value of abandoned property due within six months of filing initial disclosure
- Holders must calculate amount due as unclaimed property. For prepaid cards redeemable only for merchandise, value is “an amount in money representing the maximum cost to the issuer of merchandise represented by the certificate”
- Beware of underreporting!

# Questions?

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