

## **PAYROLL CARDS: WOULD YOU LIKE YOUR PAY WITH THOSE FRIES?**

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Not long ago, employees could only access their pay through cashing a paper check or depositing the check into the employee's deposit account and then writing checks, withdrawing funds, or using an account-tied debit card. An employer could reduce payroll costs only by directly depositing the employee's pay into the employee's bank account. This option was not available for all employers, however, because many employees do not maintain bank accounts.<sup>3</sup> Furthermore, the employee usually had to consent to direct deposit, as approximately thirty-five state laws prohibit an employer from requiring direct deposit of a paycheck.

A new option presents advantages for both employers and employees: using payroll cards. The popularity of payroll cards has skyrocketed since 2001. They are the first alternative to paper checks for employees without bank accounts and the first alternative to direct deposit that could reduce employer payroll costs. Payroll cards have the added advantage of giving an unbanked employee a fast, convenient way to access their pay without the cost of using check cashers, with the added security of having a personal identification number ("PIN") protected card and the convenience of being able to purchase items over the phone or online without needing a credit card.

Payroll cards were first used by long distance truckers in the mid-1990s, since the nature of their job often left them on the road on payday.<sup>4</sup> Payroll cards gave truckers the ability to access their pay immediately, whether they were at home or on the road. Their pay was automatically deposited to an account connected to the debit card the truckers already had in their possession. Once the pay was deposited,

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3. Approximately 22% of households are either unbanked or underbanked. Robert Soloman, *You Can't Bank on this Reality*, CONN. LAW TRIBUNE, Dec. 13, 2004, at 18.

4. Diane E. Lewis, *It's All in the Card*, THE BOSTON GLOBE, Feb. 15, 2004, at E1.

they could withdraw money at an automatic teller machine (“ATM”) or anywhere else an ATM card was accepted. Payment with a payroll card thus allowed the truckers to access their pay from any location. This convenience is one of the many benefits that have made payroll cards a popular pay method today.<sup>5</sup>

As payroll cards gain popularity, how they are regulated has become a game of guesswork. Although many issuers have been treating the cards the same as direct deposit, to do so without analyzing the federal and state laws involved could cause legal trouble for issuers. The goal of this article is to take the guesswork out of some of the legal issues surrounding payroll cards. This article first summarizes the development of payroll cards, including the advantages and disadvantages of the cards.<sup>6</sup> Then, the article discusses certain legal issues under federal and state law that financial institutions and employers face when issuing payroll cards.<sup>7</sup> Financial institutions exploring the possibility of offering payroll card products need to be aware of federal law issues such as whether the money associated with payroll cards is considered a separately insured deposit under the Federal Deposit Insurance Act (“FDIA”),<sup>8</sup> whether the consumer protections of the Electronic Funds Transfer Act (“EFTA”) and the accompanying Board of Governors of the Federal Reserve System’s (“Board” or “Federal Reserve”) Regulation E apply to the payroll cards,<sup>9</sup> and whether the customer identification procedures outlined in the USA PATRIOT Act<sup>10</sup> apply to payroll cards.<sup>11</sup> In addition, there are numerous state laws that may affect the issuance of a payroll card, which must be considered, especially if the employer utilizing the payroll card has employees in more than one state.<sup>12</sup>

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5. See Caroline E. Mayer, *From Paycheck to Plastic*, WASH. POST, Jan. 6, 2004, at E01.

6. See *infra* notes 13-41 and accompanying text.

7. See *infra* notes 41-104 and accompanying text.

8. See *infra* notes 43-61 and accompanying text.

9. See *infra* notes 62-80 and accompanying text.

10. United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, Pub. L. No. 107-56, 115 Stat. 272 (2001).

11. See *infra* notes 81-86 and accompanying text.

12. See *infra* notes 95-104 and accompanying text.

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## I. PAYROLL CARD STRUCTURE

Payroll cards are a type of stored value card, similar to a prepaid debit card, that operate on an “open loop” or universal system, which means that they can be accepted at any ATM, point of sale (“POS”), or merchant location that accepts debit cards. The cards are typically offered by an employer through a bank issuer. The employer sets up a payroll card account at the employer’s bank and deposits funds representing the employees’ wages (minus various federal and state taxes and other deductions) into the account. The bank then issues individual cards, embossed with the employee’s name, to each employee that signs up for the card. Cards typically are branded with a Visa U.S.A. (“Visa”) or MasterCard International, Inc. (“MasterCard”) logo and are connected to an ATM network, thus allowing them to be used by employees at ATMs and POS terminals.<sup>13</sup> The bank keeps track of the funds attributable to each card, typically through its back office processor, and processes all credits, debits, and fees relating to each card. On each payday, the payroll card is automatically reloaded with the amount of the employee’s net pay, but an employee cannot otherwise load personal funds or deposits onto the card.

When payroll cards were first introduced, they operated on a PIN-based system. Basically, the cards could be used as an ATM card to withdraw money or at the few POS terminals where PIN-based transactions were accepted, such as grocery, convenience, and many “big box” stores like Wal-Mart, Target, and Office Depot.<sup>14</sup> In 2001, however, both Visa and MasterCard announced that they would put significant resources behind the development of payroll cards, thus putting payroll cards on a comparable footing with debit cards associated with deposit accounts.<sup>15</sup> The attachment of a Visa or MasterCard logo to the card, a so-called “branded” card, creates a

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13. All stored value cards operate on either a “closed loop” or “open loop” system. In an open loop system, the cards are accepted on a universal network for PIN-based or signature-based transactions. In a closed system, the card can only be used at a finite number of merchant locations. Examples of stored value cards operating on a closed loop system include mass transit cards and college issued cards. Office of the Comptroller of the Currency, Community Affairs Department Analysis, *Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked*, October 2003, at 2 [hereinafter OCC Analysis on Payroll Cards], available at <http://www.occ.treas.gov/cdd/payrollcards.pdf>.

14. *Id.*

15. *Id.*

“signature-based” card that can be used like a credit card at merchants such as restaurants or department stores, which do not have PIN-based systems. Unbranded cards, or cards without the Visa and MasterCard logo, still carry the logos of different ATM networks allowing them to be accepted at ATMs and POS terminals that accept PIN-based transactions. These unbranded cards may or may not have an employee’s name embossed on them. Cards that do not have an employee’s name embossed on them can be quickly issued to any employee for immediate use. Non-embossed cards, however, have higher security risks than embossed cards as they can be used by anyone, not just the person whose name is embossed on the card.

The employees to whom payroll cards are targeted generally are not part of a population that has a strong relationship with the banking community.<sup>16</sup> When issuing payroll cards, employers generally target those employees who do not have a bank account and have little or no experience with ATMs or POS terminals.<sup>17</sup> Thus, the most difficult aspect of a payroll card program is often getting employees to accept a new product. Once payroll cards are accepted, however, banks report a low rate of attrition – those who begin using a payroll card rarely revert to using a paper paycheck.<sup>18</sup>

Since 2001, the number of banks and third party providers that offer payroll card services has surged, and the data suggest that these numbers will only increase.<sup>19</sup> More cards were issued in 2004 than at any other time since their debut.<sup>20</sup> Payroll cards make up about 25% of the cards that run through the Allpoint Network,<sup>21</sup> and estimates suggest that by 2006, up to 25% of the unbanked population will be using

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16. Surprisingly, the OCC reports that many banks have found that older employees are also interested in payroll cards. Although these employees had previously used direct deposit, they liked the convenience of having their pay directly linked to a card. OCC Analysis on Payroll Cards, *supra* note 13, at 10.

17. Employees without bank accounts tend to work in the agricultural, food processing, hospitality, manufacturing, retail, restaurant, and transportation sectors of the economy. American Payroll Association, *Paycard Overview*, at <http://www.payrollannex.org/paycard/paycardportal.cfm?pageid=2> (last visited Feb. 7, 2005).

18. OCC Analysis on Payroll Cards, *supra* note 13, at 10.

19. *Id.* at 2. In 2000, payroll cards were practically nonexistent.

20. David Breitkopf, *Review 2004: Payroll Cards Make Strides, Face Legal Hurdles*, AM. BANKER, Dec. 30, 2004, at 5.

21. Allpoint is the largest surcharge-free ATM network in the United States with more than 32,000 ATMs in retail locations across the country.

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payroll cards.<sup>22</sup> Thus, it increasingly appears that financial institutions offering payroll services to their commercial clients will need to offer a payroll card product to go along with traditional payroll services.

## II. ADVANTAGES OF PAYROLL CARDS

The numerous advantages to using payroll cards for employers and employees appear to far outweigh the disadvantages. The main benefit to employers offering payroll cards is to lower internal costs associated with payroll. It is estimated that in 2003, employers using payroll cards saved approximately \$114.4 million in payroll costs.<sup>23</sup> Moreover, employers no longer have to pay the costs associated with checks, such as handling and distributing the checks<sup>24</sup> and reprocessing lost or stolen checks. While the cost to an employer for a direct deposit transaction is about 20 cents, and the cost to issue a check is between \$1.00 and \$2.00,<sup>25</sup> the cost to issue a payroll card falls between 20 cents and \$1.00. In addition, it can cost employers up to \$10.00 to replace a lost or stolen check.<sup>26</sup> This replacement cost is eliminated almost completely when employees are paid with a payroll card or through direct deposit.

Employers also gain a convenient method to pay employees working in remote locations. Normally, payroll checks are processed where the employer is located and sent via an overnight service to the employee in time for payday. These costs can be high and in certain circumstances the overnight service may not be reliable. For example, when the nation's air transportation system was grounded after 9/11, many employers experienced difficulty in getting their payroll checks to employees.<sup>27</sup> Those employees paid with payroll cards or through direct deposit did not experience the payment delay.

Payroll cards are also advantageous to employees, particularly

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22. OCC Analysis on Payroll Cards, *supra* note 13, at 2.

23. Lewis, *supra* note 4, at E1.

24. We note, however, that many state laws still require an employee to receive a pay stub outlining the deductions that were made from his or her pay each week. *See, e.g.,* MASS. GEN. LAWS ch. 149, § 148 (2004).

25. OCC Analysis on Payroll Cards, *supra* note 13, at 6.

26. *Id.* It is estimated that four million payroll checks are lost or stolen every year, costing employers approximately \$48 million annually. *Id.* at 7.

27. *Id.* at 7.

those without deposit accounts who no longer need to use a check cashing service to access their pay. As the following table demonstrates, if the fees that banks charge for use of the card are reasonable, consumers will pay less to use a payroll card than to use a check casher or to maintain a basic bank account.<sup>28</sup> Indeed, to make payroll cards acceptable to employees, the costs associated with them need to be significantly less than the charges associated with using a check casher.

**Comparison: Sample Fees Imposed on Payroll Cards, Check Cashers, and Basic Bank Accounts<sup>29</sup>**

<b>Costs</b>	<b>Payroll Card</b>	<b>Check Casher</b>	<b>Basic Bank Account</b>
Min. monthly balance required	N/A	N/A	\$0
Min. deposit to establish acct.	N/A	N/A	\$100
Check Cashing Fee	N/A	\$8.77	\$0
Monthly Fee <sup>30</sup>	\$3.00	N/A	\$5.95
ATM Usage fee <sup>31</sup>	\$0	N/A	\$0
Money Order Fee <sup>32</sup>	\$1.00	\$1.00	N/A

28. We note that many consumer groups do not want any fees associated with payroll cards. However, any successful bank issued payroll card program will include reasonable fees to offset costs to the bank.

29. OCC Analysis on Payroll Cards, *supra* note 13, at 8. The following table assumes two paychecks of \$400 each month and three payments that would require money orders or checks each month.

30. This was the average monthly fee for payroll cards issued by large banks. *Id.* The checking account fee assumed the consumer did not use direct deposit.

31. These data assume the consumer does not use a foreign ATM to withdraw cash. *Id.* We note that some banks will give 2-4 free transactions per month but then charge for all ATM use after these free transactions have been used, whether the withdrawal is at a foreign ATM or the bank's ATM.

32. These data assume the checking account customer will use personal checks to pay bills and that payroll cardholders and check cashing customers will purchase money orders through the U.S. Postal Service. *Id.*

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<b>Total Monthly Fees<sup>33</sup></b>	<b>\$6.00</b>	<b>\$20.54</b>	<b>\$5.95</b>
Checks (box of 15)	N/A	N/A	\$8.00
<b>Total Annual Fees</b>	<b>\$72.00</b>	<b>\$246.48</b>	<b>\$79.40</b>

Payroll cards also eliminate the need to stand in line on payday to cash a paycheck and should discourage consumers from stashing large amounts of cash in their homes.<sup>34</sup> In addition, if employees are on vacation or have the payday off from work, they no longer have to go to work to pick up their paychecks. Instead, they have instant access to their cash on the morning of payday. For many employees to whom the payroll cards are targeted, their paychecks are needed on payday. Furthermore, payroll cards offer their users the benefit of many financial services that are taken for granted by the majority of the population. Payroll cards that are branded with the Visa or MasterCard logo can be used to “pay at the pump,” to shop online, or to shop from a catalog by telephone.<sup>35</sup> Some Visa or MasterCard payroll cards even allow cardholders to pay their bills online. These services would not be available to many nonbanked cardholders without the payroll card program.

There are disadvantages of using a payroll card, of course, including the fees and other limits placed on ATM withdrawals and cash back at POS merchants. Critics of payroll cards also allege that the cards do not offer enough consumer protections. However, the regulations proposed this year by the Federal Deposit Insurance Corporation (“FDIC”) and the Federal Reserve, which are described further below, if finalized, would provide pass-through deposit insurance to payroll cards and mandate certain consumer protections of Regulation E, therefore alleviating this concern. The comment letters submitted by consumer groups on the proposed regulations consistently state that they do not believe the proposed rules go far enough to protect

33. We note that not all fees associated with payroll cards and checking accounts are represented on this chart. Both payroll card accounts and check cashing accounts may have fees for negative balances. Payroll cards may also have fees for excessive phone inquiries on balance, while checking accounts have fees for bounced checks or maintaining a balance below the minimum balance. *Id.* at 9.

34. *Id.* at 7.

35. *Id.*

consumers. For example, in its comments to the FDIC on interpreting the deposit insurance issue, Consumers Union asked the FDIC to clarify that all funds underlying stored value cards that are held by a depository institution are insured deposits.<sup>36</sup>

Consumer groups also complain that while banks tout MasterCard and Visa's "zero liability" policy as a consumer protection measure, these policies are voluntary and do not replace the consumer protections enumerated in Regulation E. For example, the zero liability policies of MasterCard and Visa may not apply if a card is used at an ATM or after a certain number of unauthorized uses on the card in a year.<sup>37</sup>

Consumer groups are also concerned that the payroll card product is being offered as a means of savings, and as such, is an inadequate savings vehicle. These critics complain that the payroll card account may not help consumers accumulate capital or develop a credit history.<sup>38</sup> Payroll card accounts, however, are not designed to be savings vehicles, since deposits other than wage payments are normally not allowed and no interest is paid on the funds. Instead, payroll cards have been marketed as a safer way for employees to hold their money as an alternative to cash, not as a safer alternative to a deposit or a savings account.<sup>39</sup> Instead of carrying around large amounts of cash or hiding

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36. Letter from Gail Hillebrand, Senior Attorney, Consumer Union, to Robert Feldman, Executive Secretary, FDIC (June 23, 2004) (on file with authors) *available at* <http://www.fdic.gov/regulations/laws/federal/04cConsumerDef624.html>. The comment letter to the FDIC was signed not only by Consumers Union, but also by Arizona Consumers Council, California Reinvestment Committee, Capital Area Asset Building Corp., Center for Economic Progress, Coalition of Religious Communities, Community Legal Services, Inc. of Philadelphia, Community Reinvestment Association of North Carolina, Consumer Action, Consumer Federation of America, Democratic Processes Center, Just Harvest, Legal Aid Society of Milwaukee, Massachusetts Consumers' Coalition, Michigan Consumer Federation, National Association of Consumer Advocates, National Community Reinvestment Coalition, National Consumer Law Center, National Consumers League, Neighborhood Economic Development Advocacy Project, San Diego Housing Federation, Sargent Shriver National Center on Poverty Law, Texas Legal Services Center, UAW, U.S. PIRG, and Virginia Citizens Consumer Council. *Id.*

37. Consumers Union, *Payroll Cards: Issues for Employers*, at [http://www.consumersunion.org/pub/core\\_financial\\_services/000922.html](http://www.consumersunion.org/pub/core_financial_services/000922.html) (last visited Feb. 7, 2005).

38. Isabelle Lindenmayer, *Prepays Touted to Build History for Unbanked*, AM. BANKER, Jan. 13, 2005, at 9. Some marketers of stored value cards now report payroll card use to TransUnion LLC, one of the three large credit bureaus, so they can market stored value cards, including payroll cards, as a way for the unbanked to build a credit history. *Id.*

39. OCC Analysis on Payroll Cards, *supra* note 13, at 7. In fact, Visa notes that many cardholders leave balances on their cards instead of spending the entire balance each pay period. Mayer, *supra* note 5.



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cash in their home where it is susceptible to being stolen, cash is available to cardholders as needed through the card. If the payroll card is ever lost or stolen, it is protected with the secret PIN number and by the fact that the employee can report the card as lost or stolen and obtain a replacement card. The hope is that once cardholders become comfortable using a payroll card, they will be more willing to open a traditional bank account where they are encouraged to save money.<sup>40</sup>

In fact, an important aspect of a successful payroll card program for financial institutions will be the ability to cross sell products to payroll card users. A typical cardholder tends to be someone who does not maintain a bank account. Thus, the opportunity to cross sell products to this unbanked population, in particular checking or savings accounts, is quite promising. At least one bank that uses payroll card products has told the OCC that a significant number of payroll card users have migrated to a traditional bank account.<sup>41</sup> However, it may be too early in the history of payroll cards to know if this migration is a trend or an anomaly.

## III. LEGAL ISSUES ASSOCIATED WITH PAYROLL CARDS

Given the advantages of payroll cards to both employers and employees, and their potential for generating business for financial institutions, it is not surprising that payroll card programs are becoming increasingly popular. However, there are four principal areas of federal regulation that any financial institution considering offering a payroll card program should consider: (1) whether the funds underlying the cards qualify as separate insured deposits; (2) whether the consumer protections of the EFTA and Regulation E apply to the cards; (3) whether the customer identification procedures of the USA PATRIOT Act apply to the cards; and (4) whether certain other supervisory concerns are addressed. There are also various state law issues, particularly labor law issues,<sup>42</sup> that should be reviewed and resolved prior to offering cards. These issues are summarized below.

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40. OCC Analysis on Payroll Cards, *supra* note 13, at 9-10.

41. *Id.* at 10.

42. Other state law issues that are not summarized in this article include whether the funds underlying payroll cards are subject to state escheatment laws or whether certain fees commonly imposed on cards, such as dormancy fees, are permissible.

A. *Federal Law Issues*

## 1. Are the Funds Underlying the Payroll Cards Separate Insured Deposits?

The first federal law issue is whether the funds underlying the cards are considered deposits under the FDIA and are eligible for separate “pass-through” insurance coverage.<sup>43</sup> This issue is important from a policy point of view, because if the deposits are insured, the FDIC must reimburse each cardholder for up to \$100,000 if the card issuing bank fails. Deposit insurance is an important protection to a cardholder holding his or her weekly pay on the card. On the other hand, providing this protection could impose a cost upon the bank holding the funds if the bank is required to pay additional insurance assessments on the funds.<sup>44</sup> Such a cost would need to be incorporated into a bank’s modeling to determine the feasibility and profitability of offering payroll cards at a particular price point.

The FDIC has provided guidance three times regarding whether funds underlying stored value cards meet the definition of deposit. The

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43. The term “deposit” is defined by section 3(l) of the FDIA. For purposes of determining whether funds associated with stored value cards, such as payroll cards, are deposits, the relevant provisions of the definition of deposit are:

The term “deposit” means (1) the unpaid balance of money or its equivalent received or held by a bank or savings association in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank or savings association, or a letter of credit or a traveler’s check on which the bank or savings association is primarily liable, . . . (3) Money received or held by a bank or savings association, in the usual course of business for a special or specific purpose, regardless of the legal relationship thereby established, including without being limited to, escrow funds, funds held as security for an obligation due to the bank or savings association or others (including funds held as dealers reserves) or for securities loaned by the bank or savings association, funds deposited by a debtor to meet maturing obligations, funds deposited as advance payment on subscriptions to United States Government securities, funds held for distribution or purchase of securities, funds held to meet its acceptances or letters of credit, and withheld taxes.

12 U.S.C. § 1813(l)(1) & (3) (2004).

44. Currently, few banks are assessed deposit insurance premiums.

first, General Counsel's Opinion No. 8. ("GC8")<sup>45</sup> was issued in 1996 in response to numerous inquiries regarding when funds underlying stored value cards were considered deposits. GC8 categorized stored value cards into four types, two of which are relevant to payroll cards.<sup>46</sup> Under the first system, the bank primary-reserve system, the depository institution does not maintain individual accounts for each stored value cardholder. Instead, the institution maintains a reserve account, from which the institution disburses funds when making payments to merchants.<sup>47</sup> The FDIC stated in GC8 that funds in a bank primary-reserve system were not insured deposits.<sup>48</sup> In the second system, a bank primary-customer account system, the depository institution maintains an individual account for each cardholder.<sup>49</sup> The FDIC determined that the funds underlying such cards were insured deposits.<sup>50</sup>

In 2002, the FDIC issued a second guidance on whether the funds underlying payroll cards should be considered insured deposits and whether each employee-participant in a pooled account would qualify for \$100,000 pass-through deposit insurance or whether the entire pooled account would be limited to \$100,000.<sup>51</sup> The opinion was based on a payroll card product offered by an employer who maintained the payroll card account through a custodial account with an FDIC-

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45. Gen. Couns. Op. No. 8, 61 Fed. Reg. 40,490 (Aug. 2, 1996).

46. *See id.* The four types are: (1) a bank primary-reserve system; (2) a bank primary-customer account system; (3) a bank secondary-advance system; and (4) a bank secondary-pre-acquisition system. *Id.*

47. *Id.*

48. *Id.* at 40,494.

49. *Id.* at 40,490.

50. *Id.* at 40,494. In the third system, the bank secondary-advance system, the depository institution acts as an intermediary between cardholders and the issuing party. Specifically, cardholders give funds to the depository institution in exchange for stored value cards issued by a third party or sponsoring company. The funds are held by the depository institution for a short period of time and then forwarded to the third party. When the cardholders make a purchase, it is the third party, and not the depository institution, that forwards payment on to the merchant. In GC8, the FDIC determined that the funds were insured deposits of the third party – not the cardholders – when in the possession of the depository institution. The final system described in GC8 is the bank secondary-pre-acquisition system. This system is similar to the bank secondary-advance system in that the cardholders give funds to the depository institution in exchange for a stored value card. The difference, however, is that the depository institution purchases the cards from the third party before selling them to consumers. Therefore, the depository institution retains the funds collected from the cardholders and sends funds to merchants when cardholders make purchases. The FDIC determined that such funds were not insured deposits. *Id.* at 40,490-91.

51. Op. FDIC Staff No. 02-03 (Aug. 16, 2002).

insured bank. The account was entitled “Paycard Clearing Account for the Benefit of [Company Name] Employee Cardholders.” The FDIC concluded that whether funds underlying payroll cards are eligible for pass-through insurance depended on two factors, the first of which is the actual ownership of the deposits. To determine ownership of the funds, the FDIC assumed that the employer did not retain a reversionary interest in the funds in the deposit account. If such an interest was maintained, and funds could be reverted to the employer, the employees could not claim ownership of the funds. In order to qualify for deposit insurance, the employees themselves must have ownership of the funds.

The second factor is whether the FDIC pass-through rules are met. Under the FDIC pass-through rules, if an agent for the actual owner of the funds maintains an account, the deposit insurance can pass through the agent to insure the owners of the funds if certain requirements are met.<sup>52</sup> These requirements are: (1) the account title must indicate that the account is held in an agency capacity; and (2) the ownership interest of each principal must be indicated in the depository institution’s records, the agent’s records, or a third-party’s records.<sup>53</sup> Thus, if the bank maintains an account with a title similar to “Payroll Card Account for the Benefit of Company X’s Employees” and has deposit account records that show the ownership interest in the account, each participant in the payroll card program would be insured as to his or her interest in the commingled account.

Most recently, the FDIC issued a notice of proposed rulemaking on the definition of “insured” deposit in relation to stored value cards, including payroll cards.<sup>54</sup> In simplified form, the proposed rule states that funds underlying all stored value cards would be considered insured deposits except if the issuer of the cards was the insured depository institution and the depository institution maintained a pooled reserve account but did not maintain separate subaccounts or other records stating the amount of money owed to particular cardholders.<sup>55</sup>

Although in the proposal, the FDIC tried not to single out specific types of stored value cards, it adopted the analysis of the 2002 opinion on whether funds underlying payroll cards constituted deposits

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52. See Deposit Insurance Coverage, 12 C.F.R. § 330.5(a) (2005).

53. *Id.* at § 330.5(b).

54. Definition of “Deposit,” 69 Fed. Reg. 20,558 (April 16, 2004).

55. *Id.* at 20,562.

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eligible for pass-through deposit insurance. Specifically, the FDIC restated the fact that ownership of the funds and compliance with the pass-through deposit rules were the key issues to determine whether the funds underlying payroll cards were deposits for FDIC insurance purposes.<sup>56</sup>

Even though the proposed rules do not intend to make GC8 obsolete, as noted, the fact of the matter is that many of the systems described in GC8 are obsolete. For example, current stored value cards often combine attributes of both a bank primary-reserve system and the bank primary-customer account system. In such a system, a financial institution maintains a pooled reserve account for all cardholders but maintains subaccounts for each cardholder.<sup>57</sup> Although the FDIC recognized that there is an argument under GC8 that the funds are not insured deposits, in the proposed rule, the FDIC determined that such funds should be considered to be insured deposits. The FDIC reasoned that even if such deposits were not “conventional commercial, checking, savings, time, or thrift accounts” the money was still being held by the insured depository institution for the “special or specific purpose” of satisfying the institution’s obligations to a specific customer.<sup>58</sup>

The FDIC also chose to extend the proposed rule to all types of stored value cards instead of singling out specific types of these cards, such as payroll cards, prepaid cards, debit cards, or check cards in the proposed rulemaking.<sup>59</sup> This broad definition of what type of stored value cards constitutes insured deposits was criticized by many of the commentators on the proposed rule. For example, some commentators believed that whether funds underlying stored value products should be considered insured deposits should depend upon the view of the consumer.<sup>60</sup> These commentators believe that if the consumer is purchasing a card as a substitute for cash, he or she likely does not

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56. *Id.*

57. *Id.* In such a system, a subaccount is defined as any supplemental records maintained by the insured depository institution (directly or through an agent) that enables the institution to determine the amounts of money owed to particular persons. *Id.*

58. *Id.*; see also Op. FDIC Staff No. 97 (May 12, 1997).

59. Definition of “Deposit,” 69 Fed. Reg. at 20,562.

60. Letter from Russell W. Schrader, Senior Vice President and Assistant General Counsel, Visa U.S.A., Inc., to Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation (on file with authors) (July 12, 2004), available at <http://www.fdic.org/regulations/laws/federal/01cVISA.html>.

expect that the banking system will protect his or her funds. Thus, the agreement between the cardholder and the issuing institution should control whether funds are treated as insured deposits. It is likely that agreements for payroll cards, since they hold the net pay of an individual, may be deemed deposits for insurance purposes, and the programs structured to be eligible for pass-through insurance. Commentators argue, however, that this result should be left up to the parties to the card agreement. In contrast, consumer groups complained that the definition of stored value card was not broad enough. These critics of the proposed rule believed that the definition should be expanded so as not to exclude future types of stored value cards.<sup>61</sup> In fact, these groups would prevent financial institutions from issuing any type of stored value product without deposit insurance.

As of the date of this publication, the FDIC had not yet issued a final rule on the definition of deposit as it relates to stored value cards. Until a final rule is issued, however, issuers of payroll cards should follow the 2002 opinion if they want to characterize the funds underlying payroll cards as separately insured deposits. Since the proposed rules specifically incorporated the 2002 opinion, it seems unlikely that the 2002 opinion will become obsolete once a final rule is issued.

## 2. Should the Consumer Protection Provisions of Regulation E Apply to Payroll Cards?

A second important federal law issue is whether the protections and requirements of the EFTA and Regulation E should apply to payroll cards. The Federal Reserve appears to believe that they should.<sup>62</sup> A few months after the FDIC issued its proposed rulemaking on stored value cards, the Board issued a proposed rulemaking that would apply

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61. See Hillebrand, *supra* note 36.

62. See, e.g., Electronic Fund Transfers, 12 C.F.R. § 205.2(b) (2004). Currently Regulation E gives consumers protections for error resolution, unauthorized transfers, preauthorized transfers, and requires disclosures for accounts. Account is defined under Regulation E as “a demand deposit (checking), savings, or other consumer asset account (other than an occasional or incidental credit balance in a credit plan) held directly or indirectly by a financial institution and established primarily for personal, family, or household purposes.” *Id.*

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the protections of Regulation E to payroll cards.<sup>63</sup> It has been ten years since there has been any action taken to update Regulation E. Although the Board proposed to revise Regulation E to cover certain stored value products in 1996, the proposal was never finalized.<sup>64</sup> In fact, it was Congress that determined that the proposal should not become final. Congress imposed a moratorium on any action on Regulation E and stored value cards and directed the Board to conduct a study on whether applying Regulation E to stored value cards would affect the cost, development, and operation of stored value products. The study concluded that such regulation would adversely affect stored value products by imposing “substantial operating and opportunity costs of compliance.”<sup>65</sup> Therefore, the rule was never finalized.

In its new proposal, the Board notes that it has the authority to determine what types of accounts Regulation E applies to, particularly in light of the legislative history of the EFTA showing a clear Congressional intent to define “account” broadly. Thus, in the new proposal to redefine “account” under Regulation E, the Board has requested that payroll card products be included in the definition of account. According to the Board, “[p]ayroll card products are, in effect, designed, implemented, and marketed as substitutes for traditional checking accounts at a financial institution.”<sup>66</sup> As such, they should be classified as accounts and be subject to Regulation E.

The proposal would change the definition of “account” in Regulation E to specifically include a payroll card account directly or indirectly established by an employer on behalf of a consumer to which electronic funds transfers (“EFTs”) of the consumer’s wages, salary, or other employee compensation are made on a recurring basis.<sup>67</sup> The new regulation specifically would state that the payroll card account is subject to Regulation E regardless of whether the account is operated by the employer, a third-party payroll processor, or a depository institution. Many institutions offering payroll cards agree that Regulation E should apply to the cards and have voluntarily provided these protections when issuing such cards.

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63. Electronic Fund Transfers, 69 Fed. Reg. 55,996 (Sept. 17, 2004).

64. Electronic Fund Transfers, 61 Fed. Reg. 19,696 (May 2, 1996).

65. Electronic Fund Transfers, 69 Fed. Reg. at 55,998 (Sept. 17, 2004).

66. *Id.* at 55,999.

67. *Id.* at 55,997.

The Board would apply the proposed rule to any electronic funds transfer to or from a payroll account established in any way by an employer on behalf of an employee for receiving the employee's wages, salary, or other compensation made on a recurring basis.<sup>68</sup> The words "recurring basis" play an important role, as the payroll card account definition is not intended to include a bonus or other such compensation that is not regularly paid by the employer. Under the proposed rule, the definition does include accounts for seasonal employees or employees paid on a commission basis.<sup>69</sup>

Commentators have had varied opinions of the proposed new regulation. Consumer advocacy groups, such as Consumers Union of U.S., Inc. and Neighborhood Housing Services of New York City, Inc. wanted to expand the rule so that Regulation E would apply to all stored value products, including child support cards, unemployment cards, and refund anticipation loan proceeds cards in addition to payroll cards.<sup>70</sup> Furthermore, these groups wanted Regulation E to cover payroll card accounts that are non-recurring payments, such as a bonus payment. In contrast, organizations such as SWACHA - The Electronic Payments Resource,<sup>71</sup> and the American Bankers Association, submitted comments stating that payroll cards should be treated in a similar fashion to electronic benefit transfers ("EBT") payments in Regulation E.<sup>72</sup> Specifically, the commentators believed that when Regulation E is

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68. *Id.* at 55,999. Interestingly, the Board limited the scope of the proposed rule to payroll card products only. It therefore excluded other types of stored value cards, including gift cards and prepaid debit cards. *Id.*

69. *Id.*

70. *See, e.g.*, Letter from Edward F. Moncrief, Executive Director, Neighborhood Housing Services Silicon Valley, to Jennifer L. Johnson, Secretary, Board of Governors of the Federal Reserve System (Oct. 19, 2004) (on file with authors), *available at* [http://www.federalreserve.gov/SECRS/2004/October/20041021/R-1210/R-1210\\_9\\_1.pdf](http://www.federalreserve.gov/SECRS/2004/October/20041021/R-1210/R-1210_9_1.pdf); Letter from Sarah Gerecke, Chief Executive Officer, Neighborhood Housing Services of New York City, Inc., to Jennifer L. Johnson, Secretary, Board of Governors of the Federal Reserve System (Oct. 20, 2004) (on file with authors), *available at* [http://www.federalreserve.gov/SECRS/2004/October/20041028/R-1210/R-1210\\_14\\_1.pdf](http://www.federalreserve.gov/SECRS/2004/October/20041028/R-1210/R-1210_14_1.pdf).

71. SWACHA – The Electronic Payments Resource is one of the largest regional payments associations in the United States.

72. Letter from Dennis Simmons, President & Chief Executive Officer, SWACHA, The Electronic Payments Resource, to Jennifer L. Johnson, Secretary, Board of Governors of the Federal Reserve System (Nov. 16, 2004) (on file with authors) *available at* [http://www.federalreserve.gov/SECRS/2004/November/20041118/R1210/R1210\\_28\\_1.pdf](http://www.federalreserve.gov/SECRS/2004/November/20041118/R1210/R1210_28_1.pdf); Letter from Nessa Eileen Feddis, American Bankers Association, to Jennifer L. Johnson, Secretary, Board of Governors of the Federal Reserve System (Nov. 17, 2004) (on file with authors) [hereinafter ABA Letter], *available at* <http://www.federalreserve.gov/>



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applied to payroll cards, there should be alternatives available to the paper periodic statement, as there are for EBT payments.<sup>73</sup> These alternatives include viewing a periodic statement online or having access to the statement information over the phone or at an ATM.

Having an alternative to the paper periodic statement is one of the key issues in the proposed revisions to Regulation E for banks and employers. Banks argue that sending periodic statements adds unnecessary costs to the issuance of payroll cards. At least one bank estimated the cost to be \$6.00 per month. This could discourage banks from offering payroll cards or could increase the costs of payroll cards for employers and payroll cardholders.<sup>74</sup> Currently, some issuers of payroll cards do not send a paper periodic statement to their customers each month but instead use an alternative to the paper periodic statement. Indeed, most payroll card users have access to their statements via phone or an ATM.

Furthermore, banks have found that payroll cardholders tend to be a mobile group, without permanent addresses, who are interested in immediate information regarding their cards.<sup>75</sup> Thus, the banks believe that these consumers would be better served by having the ability to access their account information immediately, either over the telephone or over the Internet, than by receiving a periodic written statement.

There are two ways that electronic reporting could be applied to payroll cards. One way is to adopt for payroll cards the modified statement and disclosure requirements applicable to cards issued or sponsored by the government to distribute EBTs. In fact, payroll cards, with their limited reloading and debit capacity, are more analogous to the EBT product than full deposit accounts. Regulation E already recognizes the different nature of EBT transactions, and thus provides an alternative to the periodic statement and modified requirements to the initial disclosures, annual error resolution notices, and the trigger for the time period for reporting unauthorized transfers and error resolution procedures.<sup>76</sup> These same types of modified requirements could be

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SECRS/2004/November/2004118/R-1210/R-1210\_30\_1.pdf.

73. See Electronic Fund Transfers, 12 C.F.R. § 205.15(c) (2005). For an electronic funds transfer of government benefits, Regulation E allows for alternatives to periodic statements. *Id.*

74. See ABA Letter, *supra* note 72.

75. *Id.*

76. For EBT transactions, 12 C.F.R. § 205.15 states that a periodic statement is not

applied to payroll cards.

Regulation E also allows consumers of full service accounts to receive the required disclosures in electronic format if certain requirements are met.<sup>77</sup> In accordance with the Electronic Signatures and National Commerce Act ("E-Sign"), electronic communications are allowed if: (a) the institution discloses the requirements for accessing and retaining disclosures in a clear and readily understandable format; (b) the consumer demonstrates the ability to access the information electronically and affirmatively consents to electronic delivery; and (c) the institution provides the disclosures in accordance with the specified requirements.<sup>78</sup> Once these requirements are met, the disclosures required by Regulation E are sent to a consumer's email address or are made available on the Internet.<sup>79</sup> For disclosures available on the Internet, the consumer must be notified of the website where the disclosures are posted, and the disclosures must be available for 90 days after the date they first become available.<sup>80</sup>

With some modification, either type of format could satisfy the requirements for payroll cards. For example, if payroll card account statements are available online, employees could choose to print out a paper statement. Those without computer or printer capabilities could perhaps access and print the statement at their place of employment. If an employer were to represent that it agreed to make computer terminals available to all employees and to post disclosures and statements on the terminals, this may be an alternative to mailing the traditional paper statement. Those employees who desired a paper statement on their payroll card would have access to one, and those employees who are satisfied with an online statement need not print out a statement. This would undoubtedly save time and money for both the employee and the bank. Having immediate access to a statement may be a viable

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required if the consumer has access to his or her account balance readily available by telephone or at a terminal (such as a balance inquiry at an ATM). 12 C.F.R. § 205.15(c)(1) (2005). In addition, a written history of the consumer's account for the past 60 days must be available upon request from the consumer. 12 C.F.R. § 205.15(c)(2) (2005).

77. For an analysis of using electronic disclosures, see Jean Braucher, *Replacing Paper Writings with Electronic Records in Consumer Transactions: Purposes, Pitfalls and Principles*, 7 N.C. BANKING INST. 29 (2003).

78. 12 C.F.R. pt. 205, Appendix C, 17(b)(2) (2005).

79. 12 C.F.R. § 205.17(c) (2005).

80. 12 C.F.R. § 205.17(c)(2) (2005).

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alternative to sending paper statements in the mail to this mobile population.

3. Do Bank Issuers have to Comply with the USA PATRIOT Act Customer Identification Procedures?

Although no agencies have issued guidance on whether the customer identification procedures (“CIP”), or “know your customer” rules<sup>81</sup> from the USA PATRIOT Act apply to payroll cards, it is an issue of great interest to payroll card issuers. It would be unlikely for the Financial Crimes Enforcement Network (“FinCEN”), the agency that enforces USA PATRIOT Act compliance, to take the position that the CIP rules do not apply to payroll cards. The purpose of the CIP rules is to verify the identity and background of the actual user of an account. The fact that the account may technically be in the name of the employer, is likely irrelevant to regulators – they are interested in the actual person using the account.

Under the CIP rules for banks, an “account” is defined as:

[A] formal banking relationship established to provide or engage in services, dealings, or other financial transactions including a deposit account, a transaction or asset account, a credit account, or other extension of credit. Account also includes a relationship established to provide a safety deposit box or other safekeeping services, or cash management, custodian, and trust services.<sup>82</sup>

A payroll card account will likely be viewed as a “formal banking relationship established to provide or engage in services, dealings or other financial transactions.” Since under the CIP rules, banks must have programs in place to identify the customer associated with each account, banks will want to ensure such a program is in place when operating its payroll card program.<sup>83</sup> In fact many bank issuers of

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81. 31 C.F.R. § 103.120, *et. seq.* (2005).

82. 31 C.F.R. § 103.121(a)(1) (2005).

83. *See* 31 C.F.R. §§ 103.11(uu), 103.125 (2005). Not only banks are required to have customer identification and anti-money laundering programs in place. These programs are

payroll cards have structured their payroll card programs to ensure that the CIP rules are followed.

A successful CIP program has procedures in place that enable a bank to have a reasonable belief regarding the identity of each customer. At a minimum, for each customer, banks should determine the name, date of birth, address, and an identification number such as a social security number or a taxpayer identification number.<sup>84</sup> Since it may be difficult for banks to acquire this information directly, it is likely permissible for the bank to use a third party, such as the employer, to help obtain this information. Although the CIP rules do not address the exact scenario of payroll cards, they would allow a bank to obtain identifying information about a credit card customer through a third-party source.<sup>85</sup> While payroll cards are distinct from credit cards, it appears that their issuance will be handled in a manner similar to the issuance of credit cards. Nevertheless, banks will need to have proper policies and procedures in place to ensure that the third party (which for payroll cards will likely be the employer) is complying with the CIP rules developed by the bank.<sup>86</sup> Furthermore, banks may want to periodically audit the third parties to ensure that the bank's CIP guidelines are being followed.

#### 4. Should Bank Issuers Employ Procedures to Reduce Their Supervisory and Reputational Risks?

Finally, banks that issue payroll cards should consider adopting other procedures to protect supervisory and reputational risks associated with issuing payroll cards. In that regard, an OCC Advisory Letter issued on May 6, 2004 to address supervisory expectations for payroll card systems is instructive.<sup>87</sup> Before issuing payroll cards, the OCC

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also required of any business that is considered a money services business under the regulations, including check cashers and money transmitters. *Id.*

84. 31 C.F.R. § 103.121(b)(2)(i)(A) (2005).

85. 31 C.F.R. § 103.121(b)(2)(i)(B) (2005).

86. These policies and procedures, along with the banks' CIP program, need to be part of the banks' anti-money laundering program. 31 C.F.R. § 103.121(b)(1) (2005). Therefore, at a minimum, a bank must have internal policies, procedures, and controls; a designated compliance officer; an ongoing employee training program; and an independent audit function to test the program. *See* 31 C.F.R. § 103.120 (2005).

87. OCC Advisory Letter 2004-6 (May 6, 2004), available at <http://www.occ.gov/ftp/advisory/2004-6.doc>.

suggests that national banks address all compliance issues and the role of any nonbank third party. This consideration is especially important since, as noted, federal regulatory issues involving payroll cards are largely unsettled.<sup>88</sup>

The OCC recommends that national banks address certain consumer disclosure and reputational risk issues when creating a payroll card system.<sup>89</sup> First, national banks should ensure that certain items are clearly disclosed to cardholders, including material terms and fees and any costs associated with accessing the funds. The bank should further disclose any risks associated with cards that lack deposit insurance and the consequences of the bankruptcy of any third party that also holds card funds. Consumers should be informed of where and how the payroll cards will be accepted, how the funds can be accessed, and what the procedures are for error resolution.<sup>90</sup> Finally, consumers should be informed of their liability for unauthorized use of the card and should be specifically notified if the unauthorized use policy changes in any way for ATM- or PIN-based transactions.<sup>91</sup>

The OCC also recommends that a bank have certain policies in place to ensure that its reputation will not be harmed.<sup>92</sup> It also recommends that the bank perform due diligence on employers to confirm that they are conforming with all laws applicable to payroll cards.<sup>93</sup> Furthermore, banks should undertake anti-money laundering controls, which include verifying the identity of each cardholder. Finally, banks should determine if the payroll card system is being used in any way to support overdraft or “payday lending” programs.<sup>94</sup> If

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88. *Id.* at 1.

89. *Id.* at 2.

90. If the Federal Reserve issues a final rule that applies Regulation E to payroll cards, the error resolution procedures contained in Regulation E would then be applicable. *See supra* notes 62-80 and accompanying text.

91. For example, Visa and MasterCard “zero liability” policies may limit their loss policies if the card is used at an ATM instead of through a signature based transaction. Consumers Union, *Payroll Cards: Issues for Employer*, at [http://www.consumersunion.org/pub/core\\_financial\\_services/000922.html](http://www.consumersunion.org/pub/core_financial_services/000922.html) (last visited Feb. 7, 2005); *see also supra* note 37 and accompanying text.

92. OCC Advisory Letter 2004-6, *supra* note 87, at 2.

93. National banks need to comply with OCC guidance on third-party relationships for any payroll system relationship the bank has with nonbank third parties. *See* OCC Bulletin 2001-47 (Nov. 1, 2001).

94. Payday Lending programs are programs by which consumers are given a loan that will be repaid on the next payday. According to the OCC, some payroll card issuers offer direct deposit payroll advance programs. Such a program allows the employee to obtain a

these issues are evaluated and appropriate action taken, the OCC believes it reduces the risk that national banks are supporting unfair or deceptive practices by operating a payroll card system. While this guidance was issued for national banks, because all of the federal bank regulators use a risk-based approach to regulation, any financial institution may wish to consider and follow the advice set forth in the OCC Advisory Letter.

*B. State Law Issues*

Not only must financial institutions that issue payroll cards determine how to comply with various federal banking laws, they must also determine how to comply with applicable state laws, particularly state labor laws.<sup>95</sup> Each state regulates how employees may be paid, and, unfortunately for payroll card issuers, these laws are not uniform.<sup>96</sup> Only three states, Delaware, Nevada, and Virginia, have enacted laws or regulations to specifically address payroll cards.<sup>97</sup> These laws regulate such topics as how the cards may be issued (i.e. on a voluntary basis only) and the fees associated with the cards. The other forty-seven states use their general labor laws, many of which prevent a fee from being charged to access pay, to regulate payroll cards. Informal phone calls to state labor regulators in these states, asking whether payroll cards may be issued to employees in the state, reveal that many states have created their own informal policies for the issuance of payroll cards.

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loan, or an "advance on pay" that is repaid on the next payday. OCC Advisory Letter 2004-6, *supra* note 87, at 2, n.8. Because of perceived abuses by independent payday lenders and the reputational risk issue, the federal bank regulators generally have discouraged banks from being involved in payday lending programs.

95. Other state law issues, including whether the funds underlying payroll cards are subject to state escheatment laws or whether certain fees commonly imposed on cards, such as dormancy fees, are permissible, will not be discussed.

96. It is likely that state labor laws would not be preempted by the National Bank Act and OCC regulations. These laws would likely be considered to be incidental to the power of a national bank to conduct its business. 12 C.F.R. § 7.4009(c)(2)(viii) (2005). In fact, the OCC has recently announced that fees associated with gift cards are not preempted by the OCC regulations or the National Bank Act. Letter from Daniel P. Stipano, Acting Chief Counsel, Office of the Comptroller of the Currency to Thomas F. Reilly, Office of the Massachusetts Attorney General (Jan. 5, 2005) (on file with authors) *available at* <http://www.americanbanker.com/attachments/20050113CCJ8UADJ-1-massagfiling.pdf>.

97. CODE OF DEL. REG. § 65-400-013 (2004); NEV. ADMIN. CODE ch. 608 § 14 (2004); VA. CODE ANN. § 40.1-29 (2004).

Six states – Alaska, Hawaii, Maryland, Minnesota, Montana and Vermont – prohibit the use of payroll cards. The reasons for this prohibition vary. For instance, Montana would allow payroll cards only if an employee were given complete control over the account where the money is deposited. The State of Montana would want the account to be in the employee's name and allow the employee to have free access to the account in whatever manner he or she chose. However, the very nature of payroll cards, where account use is almost always limited to ATM and POS transactions, would prevent payroll cards from being used in Montana. Minnesota law prohibits the payment of salary or wages by nonnegotiable instruments.<sup>98</sup> Again, the nature of a payroll card would not fit into this definition.

In states where employees may be paid with a payroll card, other restrictions may apply. For example, a common state law requires that an employee have access to his entire pay once per pay period without incurring a fee. Often issuers get around this law by waiving enough ATM fees so the entire pay may be withdrawn or employers cover any card fees. However, the issue is complicated by the fact that most ATMs have daily withdrawal limits of \$500. Thus, practically speaking, an employee with net pay of over \$500 would not be able to access his or her entire pay through an ATM. While the employee could make purchases with the card and receive cash back, there are limits on cash back amounts as well. Thus, these practical considerations need to be squared with state law requirements on access. Moreover, one of the advantages of having a payroll card is that employees do not have to carry large amounts of cash with them – which is inconsistent with these state laws. These issues need to be addressed and clarified, and have been in certain states. For example, in California the Labor Code states that an employee must be paid without discount.<sup>99</sup> The state, however, has issued an opinion letter stating that granting employees a limited number of free withdrawals per pay period, during which the employee may access all the wages for that pay period, would satisfy this standard.<sup>100</sup>

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98. MINN. STAT. § 181.02 (2004).

99. CAL. LAB. CODE § 212(a) (2004).

100. Letter to Loren Karnick, Counsel Citicorp Services, Inc. from H. Thomas Cadell, Jr., Chief Counsel, California Division of Labor Standards Enforcement (Feb. 3, 1994) (on file with authors).

Another state law issue deals with the imposition of fees on the cards. For example, laws in Connecticut, Delaware, Indiana, Massachusetts, and Oklahoma prohibit charging any fee for use of the payroll card. Delaware law states that “[i]t is the employers’ responsibility to effectuate a payroll debit card system, which will allow full payment of wages on the employee’s regular payday and without cost to the employee.”<sup>101</sup> Delaware has interpreted “without cost to the employee” to mean that no ATM fees or teller fees can be associated with employees accessing their pay.<sup>102</sup> This requirement is inconsistent with even direct deposit of pay into employee bank accounts, as fees are often charged on deposit accounts for ATM withdrawals, checks over a certain number, or other common deposit account fees.

The last major restriction invoked by many states is a restriction that also applies to direct deposit: being paid with a payroll card must be voluntary. In Arkansas, for example, an employee must have the opportunity to opt out of payments by electronic deposit by written request to the employer.<sup>103</sup>

Because payroll cards have begun to be used more and more frequently, it is likely that many state legislatures will revisit these issues in the next few years. As noted, Virginia is the only state that has specifically addressed payroll cards in its statutes, and Delaware and Nevada have enacted regulations to control payroll cards. The Virginia Code allows an employer to pay an employee “by credit to a prepaid debit card or card account from which the employee is able to withdraw or transfer funds with full disclosure by the employer of any applicable fees and affirmative consent thereto by the employee.”<sup>104</sup> As more states take up the issue of payroll cards it will benefit the unbanked populations of such states to follow Virginia’s lead and specifically allow employees to be paid with payroll cards.

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101. CODE OF DEL. REG. § 65-400-013 (2004).

102. It should be noted that at least one state, Texas, has said that although a financial institution may charge fees associated with the payroll card, an employer may not charge fees nor receive any fees for use of the payroll card.

103. ARK. CODE ANN. § 11-4-402(b)(1)(B) (2004); *see also* Letter from Daniel Knox Faulkner, Attorney, Arkansas Department of Labor, to Carlos Portugal, Attorney, Arnold & Porter LLP (Oct. 12, 2004) (on file with authors).

104. VA. CODE ANN. § 40.1-29(b) (2004).



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## IV. CONCLUSION

In October 2003, the OCC published an article that analyzed the potential use of payroll cards by national banks to serve the unbanked and underbanked populations.<sup>105</sup> The OCC determined that before national banks could play an active roll in payroll card products, it should evaluate three factors: (1) whether payroll cards are a product that their customers want; (2) whether the bank views the payroll card holder as a potential market for cross selling other bank products; and (3) whether payroll cards will be profitable. In 2003, it was clear to the OCC that employers wanted their banks to issue payroll cards for their employees, but it was unclear whether the unbanked employees presented a good potential market for cross selling and whether payroll cards could be profitable. In the mere year and a half since the OCC article was written, it appears that the answer to the final two questions is affirmative. There has been an explosion in the issuance and use of payroll card products.

Assuming that the federal and state law issues summarized above are resolved in a reasonable manner, and disclosures and fees continue to be reasonable, payroll cards will quickly become a mainstream addition to a bank's payroll service offerings and a good alternative for many employees. Although it may take years for employees to become comfortable with the concept of a payroll card, as the United States moves toward a cashless society, payroll cards may provide a solution for the unbanked population. Legislation and regulatory change, particularly in the areas of state labor laws, once modernized to allow pay by both direct deposit and payroll cards, will help integrate payroll cards into society. Once this occurs, it is difficult to imagine employers offering a more costly wage payment, such as paper checks, instead of direct deposit or payroll cards.

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105. OCC Analysis on Payroll Cards, *supra* note 13.

