

FinCEN Proposes Overhaul of Stored Value Treatment Under the Bank Secrecy Act

On June 28, 2010, the Financial Crimes Enforcement Network (FinCEN) issued a Notice of Proposed Rulemaking (Notice) proposing substantial changes to the treatment of prepaid cards and other access devices under the Bank Secrecy Act (BSA). This proposal would replace FinCEN's current construct of treating "issuers and redeemers" of stored value separately from other money services businesses (MSBs), and largely exempting them from BSA requirements, with that of "providers and sellers" of "prepaid access." While prepaid access would remain distinct from money transmission, it would be regulated in a similar fashion and would become subject to many of the same BSA requirements that currently apply to money transmitters. Most notably, a new category of prepaid access "providers" would be responsible for suspicious activity monitoring and reporting, as well as for other registration, customer identification, and recordkeeping activities. "Sellers" of prepaid access would share in each of these requirements, with the exception of the registration requirement, for which the provider would retain sole responsibility.

The Notice poses a number of questions and invites public, industry, and law enforcement feedback to guide this and future rulemakings. However, comments are due as soon as July 28, 2010, which does not allow much time for public input to FinCEN on these proposed significant changes on how prepaid cards and access will be treated for BSA purposes.

Summary of Proposal

FinCEN signaled last year that it would be releasing the present rulemaking and had requested feedback on various elements of stored value, including, among other things, its definition, treatment of the various parties involved, and whether to distinguish between closed- and open-loop products. The current Notice provides a comprehensive summary of the development of prepaid products over the last two decades as background for the changes it proposes. The Notice concludes that, having initially spared the industry from many BSA obligations on account of its relatively young age and limited scope,

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the market has matured sufficiently to withstand the full imposition of the BSA obligations already imposed on other MSBs, even while new products are still being adopted.

Definitions

FinCEN proposes in the Notice to define “prepaid access” to mean an “electronic device or vehicle, such as a card, plate, code, number, electronic serial number, mobile identification number, personal identification number, or other instrument that provides a portal to funds or the value of funds that have been paid in advance and can be retrievable and transferable at some point in the future.” This definition goes well beyond simple cards and would encompass new technologies such as mobile payments, “e-wallets,” and other means of transferring funds that have yet to be invented. Such an expansive definition is consistent with FinCEN’s stated goal of drafting regulations that will remain relevant as the industry evolves.

While the Notice proposes to maintain aspects of the current US\$1,000 thresholds below which most BSA requirements do not apply, it creates a new top-to-bottom compliance framework for which a single entity—a “provider of prepaid access”—has primary responsibility.

The Notice states that generally the term “provider of prepaid access” “will apply to any person that serves in the capacity of oversight and control for a prepaid program.” The Notice lists those persons that participate in most prepaid programs and notes that many, including program sponsors, program managers, distributors, processors, and retailers/reload facilities, could satisfy the definition of “provider” depending on specific facts and circumstances. While acknowledging that there may be situations in which no single party offering prepaid access exercises complete control, the Notice expresses FinCEN’s belief that “there will always be a party in the transaction chain with the predominant degree of decision-making ability,” and that “that person plays the lead role among all the others, and is in the best position to serve as a conduit for information for regulatory and law enforcement purposes.”

To assist with identifying the prepaid access “provider” in a prepaid program, the proposed regulation offers several indicia of what constitutes the exercise of “principal oversight and control”:

- Organizing the prepaid program;
- Setting the terms and conditions and determining that the terms have not been exceeded;
- Determining the other businesses that will participate in the transaction chain underlying the prepaid access which may include the issuing bank, the payment processor, or the distributor;
- Controlling or directing the appropriate party to initiate, freeze, or terminate prepaid access; and
- Engaging in activity that demonstrates oversight and control of transactions.

The Notice appears to envision that a participant in every prepaid program will volunteer for the job of “provider.” However, as a result of the fact-specific nature of the analysis, the proposal creates some uncertainty as to which entity in the chain is appropriately designated the provider, or which party should rightfully assume that title and related burden. Nevertheless, it is FinCEN’s expectation, and ours as well, that the program sponsor or processor will in most cases be the “provider” for BSA purposes.

The proposed rulemaking also would define “seller of prepaid access” as “any person that receives funds or the value of funds in exchange for providing prepaid access as part of a prepaid program directly to the person that provided the funds or value, or to a third party as directed by that person.” FinCEN believes that a seller is typically “a general purpose retailer, engaged in a full spectrum product line through a business entity such as a pharmacy, convenience store, supermarket, discount store or any of a number of others.” As the party with the most “face-to-face purchaser contact,” FinCEN views the seller as “a valuable resource for capturing information at the point of sale, unlike any other party in the transaction chain.”

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Compliance Requirements

Subject to certain exclusions, both providers and sellers of prepaid access would be required under the Notice to file suspicious activity reports and collect and maintain customer and transaction information. Providers of prepaid access, but not sellers, also face new registration requirements, similar to other MSBs, and the designated “provider” in a prepaid program must supervise the program’s compliance with applicable BSA requirements. Banks and bank-centered prepaid programs, to which existing BSA regulations already apply, are not covered by the proposed regulations; however, the mere involvement of a bank in a prepaid access program—for example, in the capacity as the issuer of the prepaid card or the custodian of funds—would not exempt the program from the proposed new rules. Indeed, the proposal envisions a dual compliance framework, where banks would comply with their BSA requirements at the same time that providers and sellers comply with their separate BSA requirements—potentially resulting in multiple suspicious activity reports being filed for the same transaction.

Significantly, the proposal appears to contemplate that sellers of prepaid access, from their position of interacting with customers, will most likely be responsible for collection of customer identification and front-line monitoring for reportable activity in most instances. The workability of this proposed requirement is questionable. Most sellers of prepaid access are retail stores, including many “mom-and-pop” establishments. If this aspect of the proposal remains in the final rule, such stores may lose sales—and ultimately discontinue selling stored value—as customers either refuse to wait for store clerks to take information from other customers or refuse to provide such information themselves. The unintended result may be that customers who benefit from the safety and ease of prepaid access may return to holding and hoarding cash.

Exclusions

While most prepaid access products are covered by the proposed regulations, a number of prepaid activities, because

of their low money-laundering risk, are excluded from the new proposed BSA requirements. However, these exclusions are narrow and could potentially create unintended consequences as well. For example, prepaid access products are exempt *if* they provide solely for the following:

- Payment of benefits, incentives, wages, or salaries;
- Payment of government benefits;
- Disbursement of reimbursement funds from pre-tax flexible spending accounts for health care and dependent care expenses;
- Providing prepaid access to funds in amounts less than US\$1,000, subject to a number of conditions; and
- Providing closed-loop prepaid access (such as single-store or mall-wide gift cards), unless the product can be used internationally or if person-to-person funds transfers are permitted.

With respect to the US\$1,000 exception, it is worth noting that while sellers of prepaid access can use this provision to avoid the suspicious activity reporting and data collection requirements that would otherwise apply at higher dollar amounts, they must nonetheless implement policies and procedures to avoid prepaid access sales that would exceed US\$1,000 to a single person in a single day. Sophisticated sellers—large supermarkets, for example—may be expected to use existing systems, such as customer loyalty programs that already track purchases, to monitor for potential violations.

Notably, with the exception of closed-loop products, the ability to load funds from non-depository sources will destroy the exemptions under the proposed rulemaking. Thus, if this Notice were to be finalized as proposed, customers seeking to expand the services offered in connection with payroll cards—such as savings programs, lines of credit, or even the ability to load other funds onto the card—would be unable to do so without jeopardizing the exemption. Such a result could hamper both innovation and adoption of prepaid technology—for example, employers who might otherwise seek to meet their employees’ needs by moving

to the next generation of cards may be inclined to retain a less useful card for their employees in order to retain the exemptions. It may therefore be wise to fine-tune the exemptions so that the basic function for which card was issued, such as payroll disbursement, remains exempt, while other potential load points are subject to heightened compliance requirements.

If finalized as proposed, the provisions in the Notice will bring prepaid access fully under the BSA's anti-money laundering and recordkeeping structure, with both intended and potentially unintended consequences. We encourage participants in the prepaid arena to review the Notice and to submit comments for FinCEN's consideration. The agency has requested feedback on virtually every aspect of the proposal, including terminology, definitions, exclusions, possible alternative approaches, and issues for future consideration. However, it has given the public very little time to act, as the comment period expires on July 28, 2010.

If you would like to discuss this Notice and its potential impact on your business, please contact your Arnold & Porter attorney or:

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