On March 23, 2010, the Federal Reserve Board (Fed) issued its long-awaited final rules (Final Rules) amending Regulation E in connection with Title IV of the Credit Card Accountability Responsibility and Disclosure (CARD) Act. Not unexpectedly, the Final Rules mean some big changes for prepaid card businesses in the United States, and many companies are already scrambling to understand the full effect of the Final Rules and to implement the significant marketing, communications, processing and operational changes the new rules necessitate.

Although the Final Rules focus on gift certificates and gift cards (open-loop/network branded cards and closed-loop/store gift cards), some of the new requirements touch other types of prepaid products as well, making it necessary for all business participants in the prepaid community to become familiar with the new requirements—even if gift cards aren’t part of their prepaid product sets.

The purpose of this article is to identify the key game-changing effects of the Final Rules and to support industry members on their paths to compliance. Please note that this article is intended for general information purposes only and should not be construed as legal advice. You are urged not to act on the information in this article without consulting an attorney.

What’s In, What’s Out
The Final Rules apply to all gift certificates, store gift cards and general use (i.e., open-loop or network branded) gift cards sold or issued to consumers primarily for personal, family or household purposes. As expected in consumer protection regulation, the key areas encompassed are fees, expiration dates and disclosures.

The Final Rules specifically exempt from coverage cards, codes or other devices that are:
• Useable solely for telephone services
• Reloadable and not marketed or labeled as gift cards or gift certificates
• Loyalty, award or promotional gift cards (See the section on “Special Case of Reward Cards” on page 3.)
• Not marketed to the general public
• Issued in paper form only
• Redeemable solely for admission to events or venues

For many in the prepaid industry, the most important takeaway from this list of exemptions is that general purpose reloadable (GPR) prepaid cards are not covered. (See the gift card display requirements discussed in “Potential Effect on Non-Gift Reloadable Prepaid Cards” on page 3.)

Effective Date
There is no transition period under the Final Rules; all cards sold or offered for sale must be compliant effective Aug. 22, 2010. (See “Special Case of Reward Cards” on page 3.) Cards purchased prior to that date are not subject to the Final Rules. The absence of a transition period will surely generate a deluge of new plastic and packaging orders. The lack of a sufficient transition period has caused great consternation among both open- and closed-loop card issuers and other members of the prepaid industry.

Most Affected: Open-Loop Gift Cards
Because open-loop gift cards are heavily reliant on fees and their DNA includes expiration dates, the Final Rules will have the greatest impact on this category of prepaid cards.

• Fees. The Final Rules effectively eliminate “dormancy, maintenance and service” fees for the first 12 months after purchase (and until there is 12 months of inactivity). In addition—thanks to a strained definition of “service fees”—the Final Rules also effectively eliminate balance inquiry, ATM, reload and per transaction fees until after 12 months of inactivity.
Once a card is inactive for 12 months, the issuer may choose
each month between debiting either
the maintenance/service fees or any
other “activity-based fee,” since only
one “service” fee per month may be
charged.

Replacement card fees also are
prohibited if the underlying funds
remain valid (i.e., available to the
consumer). All other fees, such as
initial issuance fees and cash-out fees,
are permitted but must be disclosed
either on or with the card prior to
purchase. And, fees may not be
changed after a card is purchased.

Our interpretation of these
requirements banning certain types
of fees and restricting when others
may be assessed is that the goal of the
drafters was to encourage higher
upfront purchase fees and discourage
post-purchase service or activity fees.
This approach is likely to make
open-loop gift cards more expensive
for all consumers by encouraging
higher purchase fees, rather than the
current model of relatively low
purchase fees with back-end service
and activity fees imposed on a
relatively small percentage of gift card
owners based on their card usage
behaviors.

• Expiration Dates. The restrictions on
expiration dates will have a greater
impact on open-loop gift cards than
on closed-loop cards, which typically
don’t have expiration dates. The Final
Rules require gift card issuers to have
“policies and procedures in place that
provide consumers with a reasonable
opportunity to purchase a card that
has an expiration date that is at least
five years from the date of purchase.”

Further rules and commentary
regarding what those policies and
procedures need to address make
the following clear:
– As of Aug. 22, 2010, no gift cards
with less than five years validity
should be on store shelves or
j-hooks.
– Issuers that want to include
expiration dates have two choices.
They may choose to:
> Have procedures to ensure that
cards with expiration dates of
don’t expire” (or “funds expire at
a later date”) and “Contact issuer
for replacement card.” The
replacement card must be pro-
vided free, unless the card has
been lost or stolen.

• Disclosures. Clear and conspicuous
disclosures are required for all gift
cards:
– Prior to Purchase. The following
disclosures are required to be made
to consumers prior to purchase:

  – Prior to Purchase.

  – Certain Changes in Terms Forbid-
  den. It is prohibited to change any
  of the above listed terms (such as
  fees) included in the “prior-to-pur-
  chase” disclosures after the pur-
  chase is made.

  – On-Card Disclosures. The follow-
  ing items must be included on the
card itself:

“Card may expire but funds
maintained for such purposes. There is, however, no requirement to maintain a Website.)

> If the seven-year manufacture option is not selected, a statement relating to the funds not expiring (or expiring later) and how to get a replacement card.

**Impacts on Closed-Loop Gift Cards**

The Final Rules’ fee and expiration date requirements also apply to closed-loop gift cards, typically what we think of as retailer or store-branded cards. But, because the number of closed-loop programs with fees/expiration dates is relatively small, the Final Rules likely will not necessitate the significant changes in that sector—at least compared to the changes facing the open-loop segment of the industry. (Before getting too comfortable, though, please reread “Effective Date” on page 1.)

Any retail, restaurant or store gift card issuers whose cards do include fees/expiration dates must comply with the requirements applicable to open-loop gift cards. And, note, some closed-loop gift cards may have fees other than service/maintenance fees, such as balance inquiry fees. As described above, those fees also are impacted by the Final Rules.

If a gift card has neither fees nor expiration dates, no specific disclosures are required.

**The Special Case of Reward Cards**

Loyalty, award and promotional (collectively Reward) cards may be open- or closed-loop products, which is why we’ve given them their own category in this article.

The good news is that Reward cards (many of which have short expiration dates and some of which may have fees) have been exempted from the Final Rules’ requirements relating to fees and expiration dates, provided they meet the definition of “a card, code or device” that:

- Is issued on a prepaid basis primarily for personal, family, or household purposes to a consumer in connection with a loyalty, award or promotional program,
- Is redeemable upon presentation at one or more merchants for goods or services, or usable at automated teller machines, and
- Sets forth [certain] disclosures, as applicable.

The challenge with Reward cards under the Final Rules involves disclosures. The Final Rules require disclosure on the front of the card that indicates the card is issued for loyalty, award or promotional purposes (it is probably sufficient if the card is conspicuously labeled “Reward” or “Promotion”) and the card expiration date. These cards also must display, on either the reverse or front, a toll-free telephone number (and Website, if there is one) that consumers may use to inquire about the card. In addition, information about the amount of any fees and the conditions under which fees may be imposed must be disclosed—either on the Reward card or in accompanying materials.

In a twist on the Final Rules’ effective date, the requirement for Reward card disclosures applies only to cards associated with promotional programs if the period of eligibility began on or after Aug. 22, 2010. It appears, therefore, that a one-year promotional gift card program commencing on Aug. 1, 2010, for example, would not need to use compliant plastic that includes the new disclosures, even though the program extends well past Aug. 22, 2010.

**Potential Effect on Non-Gift Reloadable Prepaid Cards**

As noted in “What’s In, What’s Out,” non-gift reloadable prepaid cards (such as payroll, teen, tax refund and GPR cards) are exempted from the Final Rules. And, the reality is, such prepaid products likely could not survive in their current forms under the strictures placed by the Final Rules. The Final Rules, however, make it clear that the exemptions can be easily lost, which should motivate issuers and sellers to adhere strictly to the requirements of the Final Rules.

Specifically, to be exempt from the restrictions and prohibitions in the CARD Act and the Final Rules, the following conditions apply:

- **The Card Must Be Reloadable.** A card is “reloadable” only if its terms and conditions allow for funds to be added after the initial issuance or purchase. A temporary non-reloadable card may be eligible for this exemption as well if it is issued solely in connection with a reloadable card. The reloads can be accomplished by the consumer or a third party (such as an employer). But, the mere fact that a load is technologically possible to implement does not make the card “reloadable” if the reload functionality is not marketed and included as a feature of the card.

- **The Card Must Not Be Labeled as a Gift Card.** To benefit from the exemption, cards should not be called gift cards nor designed to look like gift cards (such as with ribbons, candles, birthday greetings, etc.). However, even taking all the right
steps to avoid a card being mistaken for a gift card (e.g., not designing the card to look like a gift card, not mentioning gift giving and including a “not-a-gift-card” disclaimer on the outside packaging) may not be sufficient to secure the exemption. Additional disclosures are needed such as POS and point-of-purchase signage where the cards are displayed. Special attention should be given to the placement of open-loop prepaid cards on gift card displays. The Final Rules give several examples of when an in-store card display preserves or undermines the exemption. What’s clear is that one should never sell non-gift reloadable cards on a shelf labeled “gift cards.”

• The Card Must Not Be Marketed as a Gift Card. Marketers of open-loop prepaid cards should be careful not to promote these cards as a gift in any way, shape or form. Not only should words such as “gift” or “present” be avoided, but the inclusion of a congratulatory message or a gift-giving/celebratory image or motif must not be used in marketing materials. In addition, policies and procedures necessary to avoid potentially misleading marketing (such as controls to regularly monitor or verify that the cards are not being marketed as gift cards and merchandising guidelines covering how the cards must be displayed in a retail outlet) should be adopted.

• Limiting Liability among the Card Supply Chain. A card may potentially lose its exempt status if any party in the distribution chain promotes the product as a gift card. As a result, the only protection from another party’s actions is establishing internal policies and procedures to ensure this from happening, in addition to contractually designating the responsibilities and possible consequences of another party’s detrimental actions. Absent this due diligence, the risk of repercussions for non-compliance increases drastically.

Other Issues Raised by the Final Rules
There is much more to the Final Rules beyond the basic fee and expiration date restrictions and disclosure requirements. The 104-page publication provides significant detail covering specific aspects of the Final Rules including insights, additional guidance and discussion of the types of comments the Fed received in response to its proposed rules.

As industry members rush to digest the “dos and don’ts” of the Final Rules, many other practical concerns are surfacing including:

• Federal Preemption. The Final Rules provide that a state law is not inconsistent with the new CARD Act and regulations if the state law provides greater protection for consumers than under the CARD Act. If so, the state law would not be preempted. Although commentators pointed out the conflict with some state escheat laws, the Fed refrained from declaring that any state’s abandoned property law was inconsistent with the federal laws. The Fed, however, reserved the right to make a determination “upon its own motion or upon the request of a state, financial institution or other interested party” as to whether the act preempts “state laws regarding electronic fund transfers, dormancy, inactivity, service fees” or expiration dates.

• Card “Real Estate” Issues. The Final Rules set forth the various disclosures required on the card itself. This includes the amounts, frequency and circumstances of any dormancy, inactivity or service fees, expiration policies regarding the funds (or if the underlying funds do not expire, that fact) and a toll-free telephone number and Website address for accessing additional card-related information. Furthermore, if the card’s expiration date is less than seven years, an on-card disclosure must be included indicating the card expires but the funds either do not expire or expire later and the consumer may contact the issuer for a replacement card. What’s most challenging about this last requirement is there’s not enough room to include this information on the back of the card and the funds expiration disclosure must be made with equal prominence and in close proximity to the expiration date on the front of the card. How will issuers balance the required on-card disclosures with the limited “real estate” available?

• Inability to Revise Certain Terms. Consumer disclosures required prior to card purchase are prohibited from being revised after purchase. This includes disclosures related to all fees and the terms and conditions of expiration of the funds.

• Broad Fee Prohibitions. While the Fed stopped short of imposing fee caps, it did adopt a broad definition of the term “service fee,” thereby expanding a term that is generally understood to refer to monthly administrative or maintenance fees to include other isolated or one-time fees such as per transaction, balance inquiry, ATM and reload fees.

• Policies and Procedures. The Final
Rules require considerable “policies and procedures” to be established before the effective date. Not only must policies and procedures be in place to ensure against improper marketing of an otherwise exempt card, but issuers and sellers also must adopt policies and procedures to ensure consumers will have a reasonable opportunity to purchase a card with at least five years remaining until the card’s expiration date.

• No Transition Rules for Cards Currently in Market. Above all, the biggest concern for the industry is the Aug. 22, 2010, compliance date. The absence of any transition rules for cards already in market makes it difficult to ensure compliance while maintaining a high level of consumer access. And, whether it’s a serious initiative or not, Sen. Charles Schumer (D-N.Y.) recently announced he intends to work with the Fed to “speed up the effective date rather than keep consumers at risk of being ripped off until next summer.”

What’s Next?
While the industry grapples with the significant compliance burdens it faces between now and Aug. 22, 2010, the Fed hinted at possible future rulemaking on matters such as whether federal law preempts a particular state’s abandoned property law and whether certain Electronic Fund Transfer Act protections should be extended to holders of prepaid cards (such as periodic statement requirements and error resolution obligations). The Fed also stated it will be monitoring the gift card market as it adjusts to the new rules to ensure that the downward trend in dormancy, inactivity and service fees continues. In other words, the challenge is just beginning.

Judith Rinearson and Margo Hirsch Strahlberg are also contributing editors to Paybefore Legal.