



Nonprofit Publisher
of Consumer Reports

November 2, 2005

Mr. Robert E. Feldman
Executive Secretary
Attention: Comment/Legal ESS
Federal Deposit Insurance Corporation
550 17th St. N. W.
Washington DC 20429
By electronic filing to comments@FDIC.gov

Re: Part 330 – Stored Valued Cards, comments on proposed rule to clarify deposit insurance application to stored valued cards

Dear FDIC:

These comments are submitted by Consumers Union, the Consumer Federation of America, the National Consumer Law Center, U.S. PIRG, and the National Association of Consumer Advocates

Nature of commenters' interest

Individuals are being asked to accept stored value cards to receive payments of essential funds. Stored value cards are increasingly offered to low- and moderate-wage workers as a way to receive and even hold funds such as wages, emergency payments, tax refunds, private child support collected through a government agency, and other important household funds. These cards are also being marketed directly to individuals as a substitute for a bank account. Deposit insurance is one of several issues that must be addressed to make the stored value card a valuable stepping stone into the banking system, rather than a high risk, inferior product.¹

¹ Separately, many of the groups signing this letter also have called upon the Federal Reserve Board to clarify the full application of federal Regulation E to all stored value cards, including payroll cards, regardless of whether the funds are held in individual accounts or in a pooled account, and regardless of how the accounting or subaccounting is performed for these cards. In addition, Consumers Union has prepared materials discussing the issues and risks of payroll cards for employees and employers, as well as the ways in which these products could be enhanced to build a stronger bridge to financial security and fuller access to the banking system for unbanked workers. That information is found at

http://www.consumersunion.org/pub/core_financial_services/000920.html, and
http://www.consumersunion.org/pub/core_financial_services/000922.html.

The legal treatment of stored value cards directly affects the desirability of these products for individuals of all income levels, but particularly for low and moderate income consumers, who cannot afford to lose the funds accessed through the card due to either unauthorized use or to the failure of a financial institution or other intermediary. Deposit insurance may have a special role to play in connection with cards being offered to the unbanked, who may need assurances about the safety of their funds. Further, disparities in the legal protections between stored value cards and traditional bank debit cards create an opportunity for yet another form of second class product for the unbanked. The decisions of the FDIC on deposit insurance, and of the Federal Reserve Board on EFTA coverage, could go a long way to preventing that outcome.

We welcome the FDIC's interest in clarifying the application of deposit insurance to stored value cards. We have three main concerns about this new proposal:

- First, the pass through concept may drive product development away from the kind of recordkeeping that would best protect consumers.
- Second, pass through insurance will not effectively protect consumers if it means that large pooled accounts will exceed the dollar amount for deposit insurance coverage.
- Third, it will be hard for any consumer to tell whether or not the card he or she holds, or is now being offered, is covered by deposit insurance.

Basic principles

We support federal deposit insurance for funds backing stored value cards. This insurance should apply, on a cardholder by cardholder basis, regardless of the nature of the financial recordkeeping associated with the card, and regardless of who maintains those records. The cardholder should be treated, and protected, as the insured depositor to the maximum extent possible. We believe that the similarities between stored value cards and bank debit cards are sufficient to create strong consumer expectations of individual insurance coverage.

Many of our groups filed comments both supporting and seeking to expand the FDIC's April 2004 "First Proposed Rule." We support the goal articulated for the Second Proposed Rule: applying federal deposit insurance to the funds underlying stored value cards. However, we cannot fully discern from the face of the proposal if it will achieve that goal.

Dangers and uncertainties caused by the pass through approach

To the extent that this proposal starts from the concept that funds backing stored value products are insured deposits, we support that approach. However, we are concerned that using the pass through rules without more augmentation or amendment of those rules may: 1) encourage the development of cards that do not require sufficient records to trigger pass through coverage; 2) interfere with effective coverage due to the per-deposit ceiling on accounts where the pass through rules do not result in pass through to the cardholder; and 3) make it hard for consumers to know if their funds are insured to them.

The operation of the pass through rules should not reward inadequate recordkeeping or influence card design to reduce recordkeeping

The proposal recognizes that in some cases it will not be possible to determine the identities of individual cardholders because neither the financial institution nor the non-bank intermediary will have the necessary information. In that case, we agree that the beneficiary of the federal deposit insurance could be the card intermediary or the employer, rather than each individual cardholder. However, it will be extremely important to ensure that this exception does not crowd out the basic principle that the deposit insurance should benefit the person who has the ultimate right to draw down the funds. Thus, we agree that pass through to the true beneficiary (the cardholder) should occur when there are any existing records showing the identity of the persons owed, and the amounts owed per cardholder, regardless of who holds those records. The rules should permit information contained on the card, or maintained by the cardholder, as information that also satisfies the pass through rules. Failure to clarify this would favor the development of cards that push recordkeeping out of the financial institution and the intermediary, such as a chip-based information system. This would violate the general goal of most regulation to be technology neutral, and it would be bad for cardholders because pushing recordkeeping toward the physical card device increases the risk of lost or corrupted records, thus increasing difficulties for consumers when the card is damaged, lost, or destroyed, or when there has been an error.

The operation of the pass through rules should not result in a lower dollar amount being covered

An even more thorny issue is that, if the deposit is treated as insured to an intermediary such as an employer, stored value card provider, or similar entity, the deposit insurance dollar cap could apply to deprive insurance to the full amount owed to cardholders. The amount in a pooled account, for example the amount held near payday for a payroll card, could easily outstrip the dollar cap on insurance coverage. This issue appears to be resolved if the preconditions for pass through in those rules are satisfied. However, if there is no pass through under those rules, then the dollar cap on the coverage, when applied to a pooled account holding funds owed to many cardholders, will be too low. The rule would have to be amended to address this.

Every card should disclose the insured and the noninsured status of the funds, and to whom the funds are insured

There is a high likelihood that consumers will believe that the funds are insured, particularly when the stored value card carries a known brand name. This makes it essential that the stored value card itself disclose whether or not the funds are insured, and if insured, to whom they are insured. The complexity of the pass through rules may make it hard for individuals to determine whether or not they are beneficiaries of the insurance.

The card itself should state whether or not the funds are insured. It is not enough to include a disclosure when there is protection, and be silent when there is no protection. The disclosure of insured or non-insured status should be printed on the card itself. Disclosures which are delivered with the card, or printed on a card sleeve, are likely to become separated from the card for ongoing use. The disclosure should include the name of the depository institution that holds the funds, and a phone number for that institution.

The FDIC's post-Katrina FAQ indicated that a common bank customer question was a question about the safety of funds once a bank or bank branch had lost its physical location. It is highly likely that holders of payroll cards and other stored value cards will want to know if their money is safe if an issuer or processor is located in a future disaster area. Noting on the card the insured status, the name of the depository institution, and a phone number of the institution could help to ease these fears; could reduce the number of inquiries, and could serve to direct inquiries to the right place. Equally important, the disclosure of the name of the depository will provide useful consumer information. Consumers deserve to know who holds their money.

Disclosure of insured status must be phrased in a way that does not mislead

We are concerned that, for those types of cards that draw from pooled accounts held in the name of a party other than the consumer, to the extent that the coverage of the Electronic Funds Transfer Act (EFTA) as to those funds is not clarified, a statement about deposit insurance could be misunderstood to suggest a higher level of security for the funds accessed by the stored value card than in fact is provided by law. If the Federal Reserve Board clarifies the application of the EFTA to payroll cards, regardless of how the funds are held, then a simple "Funds are held in XYZ bank, (phone number), and are FDIC insured" should suffice to disclose insured status.

The situation will be more complex for funds held in pooled accounts and accessed by stored value cards other than payroll cards. If the funds are insured, but the cardholder is not protected from liability for unauthorized use, then a simple statement of insurance may mislead the cardholder into believing that there is more legal protection than in fact exists. In that circumstance, the disclosure about insured status would also have to say something such as: "This insurance does not protect you from theft of funds using this card or card number."

Comments on other specific issues in the request for comment

Funds in hybrid systems are deposits

We are in strong agreement with the FDIC's conclusion that it can, and should, treat funds in hybrid stored value systems as insured deposits. This is true because of the similarity of stored value cards to other cards in consumers' hands that access similar funds. It is also important because exclusions of some or all types of hybrid systems could skew the marketplace toward less recordkeeping, or toward changes in the allocation of recordkeeping between the parties. Such a skewing would be bad for the financial system, as it would support less robust tracking when necessary for anti-money laundering, anti-terrorism, or other law enforcement activities, and would be a less useful form of recordkeeping for resolving consumer disputes.

No exceptions for bank-issued gift cards

The proposal invites comment on whether there should be a *de minimus* or other exemption for funds underlying bank-issued gift cards. There should be no such exemption. We believe that consumers who hand over funds to a bank in exchange for a promise of future payment (via a stored value card) expect those funds to be just as secure as other funds that they tender to a bank for future withdrawal. Further, an exception by card type could have unforeseen effects as the card types continue to converge, and as new uses are developed for existing card platforms. For example, a travel card or a card for college student funds may use a bank gift card platform, but be associated with much higher dollar amounts.

Involvement of third party processors should not defeat insurance coverage

We agree that there is no need to address the unusual case of insured depository issuance of cards without associated recordkeeping about amounts owed. The proposal suggests that this product may not exist. If the issue is addressed, however, it should be resolved in favor of coverage, in order to avoid creating regulatory disincentive for the keeping of useful records.

Insurance coverage should not be defeated by the form of access mechanism or the involvement of a sponsoring company

We strongly favor insurance coverage rules that do not depend on the characteristics of the access mechanism, since no one can predict how those mechanisms will change over time. In addition, the rule should not provide an avenue to escape deposit insurance coverage based on the structure of the transaction between multiple parties.

Conclusion

Stored valued cards promise an opportunity to bring persons not using traditional banking products into the electronic payments mainstream, but they cannot fulfill that promise if the cards have absent, ambiguous or inferior consumer rights and protections.

Very truly yours,

A handwritten signature in black ink, appearing to read "Gail Hillebrand". The signature is fluid and cursive, with a large initial "G" and a long, sweeping underline.

Gail Hillebrand
Consumers Union

Jean Ann Fox
Consumer Federation of America

Margot Saunders
National Consumer Law Center

Ed Mierzwinski
U.S. PIRG

Ira Rheingold
National Association of Consumer Advocates