

Written Statement of

Kirsten Trusko

On Behalf of the

NETWORK BRANDED PREPAID CARD ASSOCIATION

Before the

Subcommittee on Emerging Threats, Cybersecurity, and Science and Technology

Committee on Homeland Security

United States House of Representatives

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Chairperson Clarke and members of the Subcommittee, I am Kirsten Trusko, President and Executive Director of the Network Branded Prepaid Card Association (“NBPCA” or Association”). We are a non-profit trade organization, which seeks to serve consumers, businesses, and government through unique applications of network branded prepaid cards, and in doing so supports the growth and success of network branded prepaid cards. We represent the common interests of the many players in this new and rapidly growing payment category. The NBPCA’s members include banks and financial institutions, the major card networks, processors, program managers, marketing and incentive companies, card distributors and law firms. For additional information about our organization, may we suggest you visit our website, www.NBPCA.com. I am delighted to submit factual information that we hope will help to address your questions on a topic that is of utmost importance to our members: accurately understanding and mitigating the potential risks posed by network branded prepaid cards.

This document is designed to outline the following topics, at a high level. Should you have follow-up questions, please let us know.

1. What is a network branded prepaid card and how does it differ from other cards?
2. Why is this card type growing and popular (including quotes from the Federal Reserve and Office of the Comptroller)
3. What are the facts to correct misperceptions about network branded prepaid cards?
4. How are NBPCA’s members working with legislators, regulators and law enforcement to mitigate the potential for misuse of the cards?

I. What are “network branded prepaid cards”?

We hope to clarify some misconceptions by being clear about the facts

- First, there are many types of plastic, magnetic-stripped cards that are all called “prepaid.” That is, before one uses the card to make a purchase, one must pre-pay the funds, which are held by a bank. The cardholder uses the cards to gain access to the funds. You cannot spend a \$50 gift card, for example, until the \$50 has been paid in advance.

- However, not all prepaid cards are “network branded.” Network branded cards (sometimes referred to as “open loop” or “open system” cards) are issued by regulated financial institutions, carry the brand of a major card network (such as American Express, Discover, MasterCard or Visa) on the front of the card, and are generally¹ usable anywhere that brand is accepted. Some network branded prepaid cards are also usable at ATMs to obtain cash for limited daily amounts.
- Although many network branded prepaid cards display the word “DEBIT” on the front of the card, they are not “debit cards” in the classic sense of the word. That is, network branded prepaid cards are not linked to an individual’s personal checking, savings or other bank account. Instead, the funds are held in pooled bank accounts with data that links each card to the cardholder’s funds. This distinction enables the under-banked population to use these cards to receive child support, unemployment, and other funds that are essential to daily life, transaction that are very difficult to administer on a cash-only basis.
- Network branded prepaid cards are also separate and distinct from “retailer gift cards” (sometimes referred to as “closed loop” cards). Retailer gift cards are not issued by a financial institution and can only be used at one location (or at one chain of affiliated locations). Retailer gift cards are issued by a restaurant, store, hotel, or other retail service provider solely for use to purchase goods or services at the issuing retailer’s establishment.
- Attached to this testimony are pictures of some popular network branded prepaid cards issued by our members.

II. Why have network branded prepaid cards become so popular?

Network branded prepaid cards are a relatively new and growing product, largely developed in response to market needs not being met by other card types. They enable electronic payments and the supporting data trail, to capture what was previously transacted with check or cash. They support specific applications by customer need (e.g. the under-banked consumer as mentioned earlier) and help to reduce costs and provide a better accounting/data trail for businesses and government than when using cash or checks.

The popularity of network branded prepaid cards is attributable to their unique ability to address cardholder needs in a variety of situations including healthcare, disaster relief operations, payroll, government benefit payments, and gifting.

The benefits that network branded prepaid cards provide was noted in an article published by the Philadelphia Federal Reserve Bank’s Payment Card Center:

The benefits that open-system prepaid cards offer for consumers, providers, and issuing banks contribute to the increased adoption of these payment applications. Consumers use these cards to pay bills, make purchases, and access cash from ATM networks. Prepaid cards can also be used to secure car rentals and to make hotel and air travel reservations. At the same time, holders of prepaid cards need not secure a traditional banking relationship nor

¹ We say “generally” because some network branded prepaid cards have specialized usage which creates some limitations. For example, “teen cards” are designed so that they cannot be used in liquor stores., and health cards may have restrictions to health-only merchants and/or purchases

gain approval for a deposit account or revolving credit. Prepaid card providers may be nonbank third parties, such as employers and payroll processing companies, that can use prepaid cards as a means to convert paper disbursements, such as payroll checks, benefit claims forms, travel checks, gift certificates, and government checks, to less costly electronic payments. Finally, bank card issuers have an opportunity to serve a broader set of consumers. By offering prepaid cards, issuing banks may meet the financial needs of consumers who may not otherwise qualify for more traditional banking products, and these banks may do so with a card-based electronic payment application that essentially eliminates credit risk for the bank. (Cheney and Rhine, Prepaid Cards: An Important Innovation in Financial Services, Philadelphia Federal Reserve Bank Payment Center (Originally published in conjunction with the American Council on Consumer Interests (ACCI) (July 2006)).

Additionally, the Office of the Comptroller of the Currency, in a July 2005 report, (<http://www.occ.treas.gov/cdd/payrollcards.pdf>) compared the cost of network branded prepaid payroll cards versus the alternatives available to the under-banked, noting the following benefits:

Benefits to Employers

- Reduced bank processing fees and check handling fees
- Reduced check printing costs
- Reduced likelihood of check fraud
- Reduced check reconciliation costs
- Increased employee productivity (e.g., not needing time off during work to cash or deposit paycheck)
- Reduced lost/stolen check replacement costs

Benefits to Employees

- Reduces or eliminates check cashing fees
- Offers ability to make purchases using credit card networks
- Offers 24-hour access to funds via ATMs; no need to wait in lines
- Reduces the need to carry a lot of cash
- Makes money transfers more easily available to families
- Provides a pseudo-bank account—funds do not need to be withdrawn entirely as with using a check casher
- Please refer to Table 5 in the OCC report as it documents their comparison of consumer costs across Payroll card, Check Casher, and Basic Bank account, reflecting Payroll card as the option least costly to the consumer.

III. Misunderstandings/myths about network branded prepaid cards.

Despite the many benefits of network branded prepaid cards, aspects of these products are misunderstood. This may be because organizations not typically associated with financial products are sometimes involved in the creation and distribution of network branded prepaid cards. For example, some network branded prepaid cards are available through non-traditional distribution channels such as supermarkets and drug stores. Misconceptions about network branded prepaid cards, which have gained currency through repetition, have the potential to affect the industry

negatively —particularly with respect to issues relating to money laundering risks. My testimony today addresses several major misconceptions by providing factual information that supports a fair and accurate assessment of money laundering risks associated with network branded prepaid cards. Here are some misunderstandings about network branded prepaid cards:

Myth #1: Prepaid cards are unregulated or loosely regulated. Every network branded prepaid card (i.e., those carrying the logo of American Express, Discover, MasterCard, or Visa) is issued by a highly regulated financial institution or other regulated organization. As such, network branded prepaid cards are subject to exam, review, and oversight. For example, the FFIEC BSA/AML Bank Examination Manual (July 2006) sets forth specific requirements for examining banks regarding their “electronic cash” products (which encompasses “stored value”) including OFAC screening, transaction testing, and monitoring for suspicious activity. In addition, many prepaid card program managers, distributors, and organizations that perform specific functions relating to processing or distributing network branded prepaid cards, are regulated by state banking departments as money transmitters or check sellers. As such, they also are subject to exam, review, and oversight. State regulators are increasingly requiring money transmitters to:

- (1) Register as Mobs with FinCEN,
- (2) Have AML policies that address customer due diligence, OFAC screenings, and suspicious activity monitoring and
- (3) Have independent reviews of their AML policies.

Altogether, there are over 50 laws/regulations that apply to network branded prepaid cards. The applicability of these laws/regulations depends on a number of factors including the charter of the financial institution issuer.

Myth #2: Prepaid cards are “ideal” for money laundering. Network branded prepaid cards are actually less useful for money laundering than many other payment products for the following reasons:

- The value associated with network branded prepaid cards issued in the United States consists of funds held in a bank account in the United States. These funds can—at any time—be frozen by the card issuer and/or forfeited entirely. Unlike “bearer instruments” or chip-based cards, where whoever holds the product also holds the value, network branded prepaid cards keep the value separate, making the products less attractive to criminals.
- All network branded prepaid cards are processed through an online system that requires electronic authorization from the payment network prior to completing a purchase transaction at the point of sale or obtaining cash from an ATM.
- The system enables card issuers to decline an authorization and/or to cancel the ability to use a prepaid card. The ability of the card issuer to terminate a card’s usefulness, without requiring possession of the card, is critical—and is a feature not shared by most traditional payment products. The online system tracks and records every use of every network branded prepaid card. Unlike paper payment products (such as checks, travelers checks, money orders, and cash), network branded prepaid cards leave a traceable trail of use including place, time, date, amount, and often the nature of the transaction. This trail has already assisted law enforcement in tracking illicit activity through use of prepaid cards.

- If a network branded prepaid card issuer identifies unusual or suspicious activity, the card can be blocked from further use. Card programs routinely monitor card activity and, as appropriate, file suspicious activity reports (SARs) or notify law enforcement.

Myth #3: Network branded prepaid cards can be both anonymous and permit ATM access, with liberal load limits or no limits on the amount of cash that can be accessed. Today, “anonymous” (meaning that no identifying information is obtained from the purchaser and verified) network branded prepaid cards are limited to the gift or reward card category (although many network branded gift/reward cardholders are identified and verified as well). Such anonymous gift/reward cards have significant restrictions that minimize risk of misuse such as a relatively low maximum dollar value, no ability to access cash through ATMs, and no ability to load additional funds after the initial funds are depleted. In addition, some issuers restrict usage of anonymous cards to the United States.

Myth #4: Prepaid card issuers do not require Customer Identification Programs (CIP) nor OFAC screening for individual prepaid cardholders. Reloadable, cash-accessible network branded prepaid cards are not available anonymously. Issuers routinely subject individuals purchasing such cards to CIP and OFAC screening, to the same extent as is required for financial institutions opening “accounts” under the Bank Secrecy Act. These verification and screening procedures are identical to those conducted when any online bank account is opened.

Myth #5: A consumer can use cash to purchase a high value, reloadable network branded prepaid card from a j-hook and use it anonymously. When a consumer purchases a reloadable network branded prepaid card from a j-hook in a retail location, a process called “activation” is typically required before the cardholder may use the card for a purchase or to access cash. In other words, although the consumer may purchase the card without identity verification, he/she may not use the card until the identity verification process is complete. The activation process typically involves the cardholder telephoning the card issuing financial institution (or a specialized organization with which the issuer has contracted) and providing personal identification information. The financial institution then verifies various elements of customer information including name, address, Social Security Number, and/or date of birth using a third-party authentication system such as Experian, Lexis-Nexis, or Equifax--just as they would a bank account. The issuer also screens customers against the OFAC Specially Designated Nationals list. If the cardholder does not “pass” this process, the card is either not usable or not reloadable.

IV. The NBPCA’s Anti-Money Laundering Recommended Practices

In February 2008, the NBPCA released its “Recommended Practices for Anti-Money Laundering Compliance for U.S.-based Prepaid Card Programs.” The document provides recommendations for all network branded prepaid card industry participants to support compliance with the U.S. Bank Secrecy Act (BSA) anti-money laundering (AML) program requirements. It recommends how to implement internal controls, monitor and manage third-parties involved with prepaid card processes and mitigate risks associated with money laundering.

To ensure the document addresses the questions and concerns of law enforcement and government agencies, the NBPCA has and will continue to maintain an open dialogue with federal, state and

local regulatory agencies as well as law enforcement officials. The document address risks identified through information sharing between the industry and critical agencies that monitor financial crime. “Recommended Practices for Anti-Money Laundering Compliance for U.S.-based Prepaid Card Programs” is a practical guide to setting up, implementing and auditing a compliance program. It covers the following areas:

1. How to conduct a risk assessment.
2. How to establish a set of internal controls to achieve compliance with AML program requirements of the BSA.
3. Federal reporting requirements and red flags to look for with respect to suspicious activity.
4. Adopting and implementing programs to comply with know your customer requirements.
5. Reducing risk when working with non-financial institutions, third-party agents and processors.
6. How to implement independent compliance testing.
7. Training program guidelines for key personnel.

The NBPCA has made “Recommended Practices for Anti-Money Laundering Compliance for U.S.-based Prepaid Card Programs” available to anyone in the prepaid card industry. The report, which can be downloaded from the NBPCA website at www.nbpcacom.com, has been widely praised and was well-received both by government and private entities.

V. The NBPCA’s role on the Bank Secrecy Act Advisory Group (BSAAG)

In 2008 the NBPCA was selected for membership in the Bank Secrecy Act Advisory Group (BSAAG), a group made up of industry representatives, regulators, and law enforcement, implemented by an act of Congress. BSAAG’s role is to advise the Department of Treasury’s Financial Crimes Enforcement Network (FinCEN) on matters related to anti-money laundering risks and Bank Secrecy Act compliance. In addition to its role on BSAAG, the NBPCA co-chairs the Stored Value Subcommittee, a Subcommittee focused on the potential risks presented by prepaid cards and the ways to mitigate those risks.

VI. Risks presented by data security breaches.

Data security breaches and the misuse of consumer account information by criminals and money launderers is an increasing problem for the US payment system. Because network branded prepaid cards use the same card payment infrastructure as credit cards, prepaid cardholders can be victims of such data security breaches. However, because prepaid cards are not connected to an individual’s bank account or credit card accounts, the risks posed by such data breaches tend to be far less for prepaid card issuers than they are for credit and debit cardholders. This is one of the reasons consumers who also use credit and debit cards, are attracted to prepaid card use as any breach of the card limits access to only the balance available on the card. And of course, like credit and debit cardholders, most network branded prepaid card holders are protected against losses from unauthorized use, thanks to the card brands’ “zero liability” policies which are incorporated into the payment network operating regulations governing issuers.

VII. Conclusion

Network branded prepaid cards are a new and valuable payment product for consumers, businesses and government. As with any payment product, network branded prepaid cards can be misused by the criminal element. Nevertheless, the NBPCA has long encouraged practices that reduce the opportunities for prepaid cards to be used in illicit activities. Prepaid cards are vital and important products which serve a substantial number of people, including those that are under-banked and would have no other connection to the banking infrastructure so critical to daily life in the US. . The NBPCA continues to support national and international efforts to combat money laundering, terrorist financing and financial crime. We are also committed to ensuring that our products are available to help consumers and businesses maintain access to the payment system, have secure and protected payment products, and reduce costs and inefficiencies for consumers, businesses and government.