Consumers Union
Consumer Federation of America
U.S. PIRG
Arizona Consumers Council
California Reinvestment Coalition
Coalition of Religious Communities
Jacksonville Area Legal Aid
Neighborhood Economic Development Advocacy Project
Virginia Citizens Consumer Council

and

Professor Sarah Jane Hughes
Professor Mark E. Budnitz
Professor Norman I. Silber
Assistant Professor Alan White

August 25, 2008

The Honorable Sheila Bair
Chair, Federal Deposit Insurance Corporation
550 17th St. NW
Washington, DC 20429-9990

Re: Request for the FDIC to extend and clarify individual FDIC deposit insurance coverage for wages and significant household funds held via prepaid cards issued by insured financial institutions

Dear Chairwoman Bair,

The public puts money and confidence in U.S. financial institutions partly because of the safety net of federal deposit insurance. The development of prepaid cards of various types not specifically connected to individual deposit accounts has created uncertainty and gaps in the deposit insurance safety net that must be closed now, as the nation begins to grapple with an anticipated series of bank failures.

We are particularly concerned about various forms of prepaid cards, also called stored value cards, that hold the wage payments of individuals and other funds that are important to individuals and families. Clear insurance coverage for each individual cardholder is necessary for prepaid cards such as: 1) employer-arranged payroll cards, 2) self-arranged general spending prepaid cards, 3) cards that contain tax refund payments or tax refund loan proceeds, 4) cards containing an employee's flexible

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spending account pretax set aside funds, and 5) bank issued gift cards, particularly those that can hold larger dollar amounts or can be used like general spending prepaid cards.

We refer to these cards collectively as prepaid cards. All of these cards can be set up by the issuing financial institution without creating an individual account. Because the funds can be held in a pooled account, the dollar amount of that account could easily exceed the deposit insurance limit. Individuals and those who advise individuals will be asking these questions:

> Who is the beneficiary of any insurance on the account holding the prepaid funds?
>
> Do the deposit insurance dollar caps apply to the pooled amount or to the amounts within the pooled account representing the amounts owed to each individual?
>
> Where funds for a card have been prepaid to the bank, is there an account on which any insurance applies?[1]
>
> How can I know whether deposit insurance covers the funds on a prepaid card?

The public needs clear, simple, and reassuring answers from the FDIC to these questions now – as the U.S. faces the beginning of a wave of financial institution failures.

Current law, as described in General Counsel Opinion Number 8, does not provide a rule that can be clearly understood by the public from looking at the face of the card. Instead, that opinion divides prepaid cards issued or sold by banks into four categories, depending on the bank's accounting and other arrangements with third parties. Only one of those categories is insured to the cardholder. A second category is insured to the third party, which means that if the card program overall has balances above the $100,000 deposit insurance limit, not all of the funds will be insured. The other two categories of back-end card setup appear to lack deposit insurance.

Consumers Union, the Consumer Federation of America, U.S. PIRG, and consumer and community organizations from New York, Florida, California, Arizona, Utah and Virginia, joined by four law professors with specialties in payments or consumer protection law, ask the FDIC to take three steps:

- As part of a national policy for the receivership, conservation or liquidation of failed financial institutions, adopt and announce a policy that all prepaid card obligations of failed financial institutions will be honored in any receivership,

[1] This latter issue is of concern for all types of general prepaid spending cards, special prepaid cards such as loan proceeds cards, and for bank-issued gift cards.

conservatorship, or resolution of a financial institution to the same extent and the same dollar limits per individual cardholder as if they had been deposited by individuals into individual deposit accounts.

- Issue the August 2005 proposal called the "Second Proposed Rule," and entitled "Part 330 –Stored Value Cards," effective immediately. This could be done as a final rule, or as an interim final rule if the FDIC wishes to seek comments on the need for further action concerning our third recommendation. Issuing the rule, effective immediately, would be an important step to protect existing household assets and wages held through prepaid cards and other nontraditional access mechanisms.

- Commence a new rulemaking to determine whether any further improvements should be made to clearly define as insured deposits *all* funds that individuals or employers prepay or pre-deposit which are paid to a bank or held in a bank in a pooled account for access or draw down using a prepaid card or other nontraditional access mechanism. The new rulemaking could address the proof issues when neither the bank nor the intermediary has the proper records to show who is owed what amounts. This may be important if any other claimant is present.

The "Second Proposed Rule" was published in the Federal Register on August 8, 2005,[2] and has already been the subject of interagency consultation and public comment. It would add a new paragraph at Part 330.5(c) to apply deposit insurance to all forms of nontraditional access devices. If adopted, this rule would protect prepaid cards and likely successor methods which may include a key fob, chip, or computer code to access prepaid funds. This rule would protect prepaid funds protected unless the bank records affirmatively show that they belong to the intermediary and not to the cardholder, or unless neither the bank nor a card intermediary has any records to show who is owed what amounts. Consumer groups filed generally favorable comments on that proposal in 2005. *See generally,* http://www.consumersunion.org/pdf/FDIC1005.pdf.

Prepaid cards represent the types of funds that need deposit insurance protection

All types of prepaid cards are funded with the hard assets of American families, precisely the types of funds that the FDIC deposit insurance system was designed to protect. As the U.S. Supreme Court has said:

> Congress' purpose in creating the FDIC was clear. Faced with virtual panic, Congress attempted to safeguard the hard earnings of individuals against the possibility that bank failures would deprive them of their savings. Congress

[2] 70 Fed. Reg. No. 151, p. 45571.

> passed the 1933 provisions "[i]n order to provide against a repetition of the present painful experience in which a vast sum of *assets and purchasing power* is 'tied up.'" S. Rep. No. 77, 73d Cong., 1st Sess., 12 (1933) (emphasis added). The focus of Congress was therefore upon ensuring that a deposit of "hard earnings" entrusted by individuals to a bank would not lead to a tangible loss in the event of a bank failure.

FDIC v. Philadelphia Gear, 476 U.S. 426, 432-433 (1986).

Unless deposit insurance is clarified, individuals and families who have participated in a prepaid card program and have entrusted to a bank wages and other household funds - the very types of assets and "hard earnings" to which the Court refers - could experience exactly the type of loss or delay in access to funds that deposit insurance was designed to avoid.

Prepaid cards can be used by individuals and families much like deposit accounts, and often are marketed for this purpose. Wages can be directly deposited to the card account, cash withdrawals made, and point of sale and online purchases made using the card. Indeed, one expert has described network branded prepaid cards as "functionally interchangeable with traditional debit cards," and said: "general-use cards can provide a number of critical bank-like services outside traditional banking account relationships."[3] The absence of clear deposit insurance protection for the funds these products represent could induce a loss of confidence in the deposit insurance system and could also result in households who can least afford it losing money in a bank failure.

Protecting prepaid card funds on bank-issued and bank-sold cards will protect both cardholders and public confidence

The actions we request today from the FDIC would protect public confidence in the deposit insurance safety net and would protect individuals and families holding wages or other funds significant to the household on a payroll card, general spending prepaid card, tax refund card, financial institution-issued gift card, or similar prepaid card. **This change is urgently needed – before there is a failure of a financial institution with a significant volume of funds held for use through prepaid debit cards not tied to individual accounts**. A failure of any financial institution with a sizable portfolio of prepaid general spending cards, loan proceeds cards or payroll cards could create and solidify a "banks can't be trusted" point of view in communities that are already underbanked. Lack of strong clear rules applying deposit insurance on a per cardholder basis also could cause real economic hardship to families who might experience a delay in receiving, or even a loss of, part of their already earned wages or other significant household funds.

[3] J. McGrath, *General-Use Prepaid Cards: The Path to Gaining Mainstream Acceptance*, Discussion Paper, Payment Cards Center, Federal Reserve Bank of Philadelphia, March 2007, at 6.

Individuals have important funds at stake. In 2006, the Mercator Advisory Group estimated annual open loop prepaid card spending at $14.1 billion, and the market has continued to grow rapidly since then.[4] At the current federal minimum wage, $14.1 billion in prepaid card funds represents more than 20 million annual hours of work by U.S. workers.[5]

One of the policy questions the FDIC previously asked was whether to apply deposit insurance to funds held for access by a bank issued prepaid gift card. We believe that this would promote public confidence, and that it is essential because amounts of $500 and $1,000 can be placed on those cards, inviting use for household budgeting. Reload capacity also invites account-type use of these cards. It would be extremely hard to properly protect household funds if a line were to be drawn between prepaid general spending cards and prepaid gift cards, which may be issued using the same platform. In addition, a failure of a financial institution with a large gift card portfolio could result in smaller per-household losses but a much wider impact on public confidence if people start to tell their friends and neighbors about the money that they lost in a bank failure. Finally, because increased attention is now being paid to the risks of retailer bankruptcy in the loss of value held in retailer gift cards,[6] people will soon be asking the next question: "Could I lose my money on a bank-issued gift card in a bank failure?"

The FDIC could take a very significant step toward protecting important household assets of U.S. consumers held via prepaid cards by: 1) adopting an emergency policy to treat these card funds the same as insured deposits as a matter of resolution policy, 2) issuing as a final or an interim final rule, with immediate effect, the "Second Proposed Rule" on deposit insurance for stored value cards and other nontraditional access mechanisms, and 3) opening a new docket to determine what more needs to be done.

Conclusion

When an insured financial institution fails, the FDIC, other bank regulators, consumer groups, other experts and the media can and should all give the public a single, valuable message: "Your deposits are safe [up to the FDIC insurance limits]." That message did not prevent a temporary and localized panic at the time of the recent IndyMac closing, but it probably did prevent the initial overreaction to that failure from

[4] See excerpts from *Third Annual Closed Prepaid Market Performance: Spend, Growth and Opportunity*, (October 2006), posted at: http://www.mercatoradvisorygroup.com/index.php?doc=Prepaid&action=view_item&id=157&catid=16. This estimate excludes the much larger closed end card market, thus excluding retailer cards and transit cards.

[5] This number will be reduced to the extent that cardholders earn more than the federal minimum wage, and the amount at risk at any one moment in time will also be much less, since this is based on annual spending and not on average balances. We did not find reliable public information about the balances held on these cards.

[6] *Sharper Image Demonstrates the Perils of Gift Cards, Consumer Reports* Money Blog, http://blogs.consumerreports.org/money/2008/03/sharperimage_gi.html

spreading into a more generalized bank run. However, no similar clear and truthful "don't worry" message can be given under the current state of the regulations for payroll cards, general spending prepaid cards, tax refund/loan prepaid cards, or bank issued gift cards. This must be changed now, before a major failure damages public confidence and individual families in ways that will be hard to repair. We look forward to working with you in any appropriate way to bring about this certainty as soon as possible.

Very truly yours,

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