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The Effect of the Fed's Final Rule on Your Prepaid Program: The 13 Questions You Must Ask

By Judith Rinearson, Bryan Cave LLP



The Federal Reserve Board issued its [final rule](#) implementing the Durbin Amendment to the Dodd-Frank Act on June 29. And now the real work begins for the industry and its participants—changing programs, business models, disclosures, contracts and more to bring thousands of affected programs into compliance.

But before you can dig in, you need to know if your organization and its prepaid programs are covered by the Fed's final rule. And if they are, what that means. Having worked closely with many clients in the prepaid space, I recognize that understanding whether or not you're covered is no small challenge as the rule the Fed gave us is complex and included a number of totally

unanticipated surprises.

The 13 questions posed in this article can help you identify whether you as an issuer or your prepaid card program is eligible for the interchange exemption, fraud prevention adjustment and routing/exclusivity exemptions. Answer yes or no to the question(s) posed in each section and, based on your response, view the likely coverage. Be sure to read all questions because an exemption on one criterion may be superseded by another factor.

Two cautions: First, it has only been two weeks since the final rule was issued, and there are still some uncertainties about interpretation. It's possible there may be

continued



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The 13 Questions You Must Ask

further clarifications issued that may affect the outcome of your program assessment. Second, these charts are intended to help you understand your obligations under the Fed's final rule to implement the Durbin Amendment, but they do not

constitute legal advice, and they don't replace a thorough examination by your in-house or outside legal counsel and compliance experts.


So, before you make any move, check in with your own experts.

Section A

Is Your Prepaid Card Covered by the Fed's Interchange Caps?

The Fed's final rule provides a number of exemptions from the interchange fee caps, but specific criteria must be met.

Q Ask Yourself	If Your Answer is NO, then ...	Important Notes
<p>Q1 Does the prepaid card work on a four-party system? (1) If YES: The prepaid card may be covered. Go to Q2. ↓</p>	<p>If NO: If the prepaid card works on a three-party system, such as American Express, it is excluded from both interchange and routing/exclusivity regulations. See !!! below.</p>	<p>(1) A four-party system involves a cardholder, card issuing bank, merchant (acquirer) bank and merchant. Both Visa- and MasterCard-branded cards are typically four-party systems.</p>
<p>Q2 Are the prepaid card funds held in a bank account <i>other than</i> a bona fide (IRS-compliant) trust account? If YES: The prepaid card may be covered. Go to Q3. ↓</p>	<p>If NO: A prepaid card drawing on funds held in a bona fide trust account is excluded from both interchange and routing/exclusivity regulations. See !!! below.</p>	
<p>Q3 Does the prepaid card "issuer" (2) together with its affiliates (3) have assets <i>greater than</i> \$10 billion? If YES: The prepaid card may be covered. Go to Q4. ↓</p>	<p>If NO: The prepaid card is excluded from the interchange exemption but routing/exclusivity regulations may apply. See ✓ below.</p>	<p>(2) The issuer is the banking entity that holds the asset account that is debited through an electronic debit transaction and that authorizes cardholders to use the cards. (3) To be an affiliate, an institution must control, be controlled by or be under common control with the issuer. A small issuer that provides prepaid issuance services for large entities is excluded unless the large entity is under common control with the issuer. An affiliate includes foreign entities.</p>
<p>Q4 Is the prepaid card open loop, including a RAN product (4), and is it either a consumer-only product, a business-only product or a combination of the two? (5) If YES: The prepaid card transaction may be covered. Go to Q5. ↓</p>	<p>If NO: If the prepaid card is closed loop or usable solely at ATMs, it is not included under the definition of debit card and, therefore, is excluded from both interchange and routing/exclusivity regulations.</p>	<p>(4) Open loop means the prepaid card is usable at multiple unaffiliated merchants. RAN means restricted authorization network, such as some campus or mall cards, usable at a limited number (as few as two) unaffiliated merchants. (5) There are no exclusions for business or corporate products.</p>

Q Ask Yourself	If Your Answer is NO, then ...	Important Notes
<p>Q5 Is the open-loop prepaid card <i>not provided</i> pursuant to a federal, state or local government-administered payment program? (6)</p> <p>If YES: The prepaid card transaction may be covered. Go to Q6. ↓</p>	<p>If NO: If the prepaid card is provided pursuant to a government-administered payment program, the prepaid card is likely eligible for the interchange exemption but routing/exclusivity regulations may apply. NOTE: This exclusion may be lost due to certain fees charged. See Q9.</p>	<p>(6) Government administered includes jury duty cards or cards issued by Tribal nations.</p> 
<p>Q6 Is the open-loop prepaid card either (i) not reloadable or (ii) marketed or labeled as a gift card or gift certificate? (7)</p> <p>If YES: The prepaid card appears to be covered by the Fed's final interchange rule. See X below.</p>	<p>If NO: If the prepaid card is reloadable and not marketed/labeled as a gift card or gift certificate, it may be excluded from the interchange regulation, provided: (i) the prepaid card account was structured to meet the Fed's final rule (See Q7 and Q8); and (ii) the exclusion is not lost due to certain fees charged. See Q9.</p>	<p>(7) This includes a reloadable card that is a gift card or any nonreloadable card—whether or not a gift card. Such a card also may be subject to routing/exclusivity regulations.</p>
<p>Q7 Was the prepaid card issued or approved for use to access or debit any account held by or for the benefit of a single cardholder—other than a subaccount loaded on a prepaid basis? (8)</p> <p>If YES: The prepaid card is covered by interchange and routing/exclusivity regulations See X below.</p>	<p>If NO: If the prepaid card funds always are held in a pooled account or subaccount for at least two or more cardholders, it may be excluded from interchange regulation. But see Q8.</p>	<p>(8) A subaccount is an account within an account, opened in the name of an agent, nominee or custodian for the benefit of two or more cardholders. An account opened solely for a single cardholder is not a subaccount under the Fed's final rule.</p>
<p>Q8 Does the prepaid card provide additional means (9) for the cardholder to access funds? (10)</p> <p>If YES: The prepaid card is covered by interchange and routing/exclusivity regulations. See X below.</p>	<p>If NO: The prepaid card transaction is excluded from interchange regulation but routing/exclusivity regulations may apply. NOTE: This exclusion may be lost due to certain fees charged. See Q9.</p>	<p>(9) “Additional means” means other than the card itself at the POS or ATM and may include convenience checks or ACH bill payment services.</p> <p>(10) According to the Federal Reserve Board, “additional means” of access implies that the account is set up for the benefit of a single cardholder—and is not a true pooled account. But the rule itself doesn't make this distinction. There may be some convenience check and ACH bill pay programs that are not linked to a single cardholder account.</p>

Q Ask Yourself

Q9 If you have the benefit of the exemption for government-administered prepaid cards (Q5) or for reloadable general use prepaid cards (Q 6-8) (11): Do you plan to charge, after July 21, 2012, overdraft fees (12) or, if you are an issuer, a fee for the first ATM withdrawal per month from an ATM that is part of your designated ATM network?

If YES: The otherwise exempt prepaid card is covered by the interchange and routing/exclusivity regulations. See **X** below.

If Your Answer is NO, then ...

If NO: The prepaid card is excluded from the interchange regulation but routing/exclusivity regulations may apply. See **✓** below.

Important Notes

(11) If you benefit from these exclusions, you can lose the benefit if, after one year after the effective date of the Fed final rule, you impose either an overdraft or ATM fee (as described in the second paragraph of Q9).

(12) An overdraft fee includes a shortage of funds or a transaction processed for an amount exceeding the account balance.



Notes

!!! If your prepaid card is entirely outside the scope of the Fed's final rule—either because your card is a three-system card or accesses funds held in a *bona fide* trust account, you are truly home free and not subject to either the interchange or the routing/exclusivity requirements.

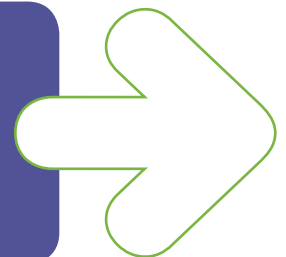
X If your prepaid card is not eligible for any exemption—because it's part of a four-party system, is a non-reloadable open-loop prepaid card, or is a four-party system open-loop gift card, or is a four-party system, reloadable general use prepaid card that provides access to the funds through additional means, or which has subaccounts for individual cardholders—then the prepaid card is covered by the interchange and routing/exclusivity regulations. Under 12 CFR Part 235, Section 235.3, the applicable interchange will be capped at 21 cents plus five basis points (0.05 percent) multiplied by the amount of the transaction.

✓ If your prepaid card is eligible for the interchange exemption and appears *not* to be covered by the Fed final interchange rule, you need to wait to see what the payment networks do:

- First, the payment network must set forth procedures to certify your eligibility for the exemption.
- Second, the payment network must determine what interchange applies to your electronic debit transactions.

While some payment networks have indicated an intention to move to a two-tier system for exempt and non-exempt transactions, if required by regulation to do so, the pricing for exempt transactions is as yet uncertain. The Fed final interchange rule does not require payment networks to provide a two-tier interchange system. And, even if a payment network does so, there is no obligation to make the exempt higher tier at the same level as the current interchange rates.

**Keeping going.
Find out if you're
eligible for the fraud
adjustment or subject
to routing/exclusivity
requirements.**



Section B

Is Your Prepaid Card Eligible for the Fraud Prevention Adjustment?

A prepaid card that is not exempt (subject to the Durbin interchange cap set forth in Section 235.3 of 21 cents plus five basis points per transaction) may be eligible for a “fraud prevention adjustment” based on its fraud prevention program.

Q Ask Yourself

Q10: Do you have fraud policy and procedures in place (13) and do you review them at least annually, update them as necessary and annually certify compliance to your payment card network(s)?

If YES: You should be eligible for an additional 1 cent fraud prevention increase on the applicable interchange fee for your electronic debit transactions.

If Your Answer is NO, then ...

If NO: You are not eligible for the 1 cent fraud prevention increase.

**Important Notes**

(13) To answer yes, your fraud policy and procedures must:

- Identify and prevent fraudulent electronic debit transactions;
- Monitor the incidence of, reimbursements received for, and losses incurred from fraudulent electronic debit transactions;
- Respond appropriately to suspicious electronic debit transactions so as to limit the fraud losses that may occur and prevent the occurrence of future fraudulent electronic debit transactions; and
- Secure debit card and cardholder data.

Section C

Is Your Prepaid Card Subject to Routing & Exclusivity Requirements?

Even if you are exempt from interchange cap regulation, your prepaid card program still may be subject to routing/exclusivity requirements.

Q Ask Yourself

Q11: Do you issue a general use prepaid card usable at multiple unaffiliated merchants?

If YES: Your prepaid card is likely subject to the routing/exclusivity regulations. Go to Q12. ↓

If Your Answer is NO, then ...

If NO: As a closed-loop prepaid card or a product usable only for ATM transactions, the prepaid card is not subject to the routing/exclusivity regulations. See ✓ at right.

Q12: Does the prepaid card work on a four-party system?

If YES: The prepaid card is likely subject to the routing/exclusivity regulations. Go to Q13. ↓

If NO: If the prepaid card transaction works on a three-party system, such as American Express, it is excluded from both interchange and routing/exclusivity regulations. See ✓ at right.

Q13: Are the funds held in a bona fide trust, in accordance with the requirements of the Internal Revenue Code?

If YES: The prepaid card is excluded from both the interchange and routing/exclusivity regulations. See ✓ at right.

If NO: The prepaid card transaction appears to be covered by routing/exclusivity requirements. See ✗ at right.

Notes

✓ Your card *is not* subject to the Fed’s final rules for routing/exclusivity. You may select one or more authorization and routing methods without limitation.

✗ Your card *is* subject to the Fed’s final rules for routing/exclusivity. The prepaid product—whether it is a card, key fob, mobile phone or other device—must provide at least two unaffiliated payment card networks. The unaffiliated networks may be one signature and one PIN network, or two PIN networks or two signature networks. The payment networks may not inhibit merchant routing choices nor an issuer’s ability to contract with any other payment card network that may process an electronic debit transaction involving the issuer’s debit cards. Ⓞ