Imperfect Protection

Using Money Transmitter Laws to Insure Prepaid Cards

General purpose reloadable prepaid cards allow customers to direct deposit their paychecks and perform functions such as paying bills just like a checking account.[1] But unlike checking accounts, a fundamental financial product held by 9 in 10 American households and carrying up to $250,000 in mandatory deposit insurance per customer, these cards are not required to carry deposit insurance.[2]

Nonetheless, the market for general purpose reloadable, or GPR, prepaid cards is growing fast, with Americans expected to load over $200 billion onto these cards this year.[3] Without this mandated insurance and other consumer protections that apply to checking accounts, these prepaid cards could become second-tier products that consumers purchase and use at their own risk.

In *Loaded with Uncertainty: Are Prepaid Cards a Smart Alternative to Checking Accounts? (September 2012)*, Pew recommends that:

- All general purpose reloadable prepaid cards be required to carry federal deposit insurance
- The Federal Deposit Insurance Corporation and Consumer Financial Protection Bureau use their supervisory authority to make certain that all funds held on these cards are insured
- The FDIC modify its regulatory regime to close gaps in insurance coverage that could put consumers' funds that are loaded on prepaid cards at risk

Pew found that most prepaid card disclosures purport to hold funds in FDIC-insured accounts through what is known as "pass-through insurance," but at least one provider in the market does not do so. Instead of holding funds in a bank so that each customer has up to $250,000 in FDIC insurance should the underlying bank fail, American Express cards operate under state money transmitter laws.[3]

In order to operate in this manner, a business must obtain a license in accordance with each state's law and is generally required to post a surety bond. A surety protects a creditor, in this case the general purpose reloadable prepaid cardholder, against default on an obligation in the event of insolvency or bankruptcy by the card issuer.[5] The amount of money that must be posted differs by state, and generally also varies depending on several factors, such as the number of locations or the financial strength of the licensee.[6] The median minimum bond obligation across the states is $75,000. The median maximum bond requirement is $500,000.

Thirty-seven states and the District of Columbia require investments by state money transmitter licensees to be held against outstanding debts.[7] All but three of these states require investments against 100 percent of outstanding debts. Almost all of these states also limit what investments are permissible. In general, state laws require money transmitters to hold securities that receive at least one of the highest three grades by a national ratings agency such as Moody's Investor Services Inc., Standard & Poor's Financial Services LLC, and Fitch Ratings, Inc.[8]

Ten states require only that a money transmitter have a surety bond.

Financial regulators in most states are responsible for examining the financial health of prepaid card providers. However, the extent of this oversight will greatly vary by state, depending on whether a particular office has the resources and interest in closely monitoring these companies. Montana, New Mexico, and South Carolina do not require a license, a surety bond, or investments of any kind. They also do not examine or supervise prepaid card providers.

State money transmitter laws were not originally designed to regulate prepaid cards. As of 2002, only 11 of the 45 states that had money transmitter laws included provisions covering stored-value products such as prepaid cards.[9] Additionally, when states first added stored-value cards to their money transmitter licensee statutes, the market for what we now think of as general

MONEY TRANSMITTER LAWS LACK CERTAINTY AND SECURITY

Funds held by non-bank money transmitters are not covered by FDIC insurance. Instead, these companies post surety bonds in accordance with state laws.

	Funds Held In A Bank	Funds Held By Money Transmitter
Regulatory Rules and Oversight	FDIC	Varies by state; no oversight in three states
Type of Security	Government-backed insurance	Private surety bond
Amount of Protection	$250,000 per cardholder	Depends on size of surety bond and number of claims
When Funds Are Available After Default	Generally immediately, but always within one business day	Depends on the process, ranging from days to months

RELOADABLE PREPAID CARDS LACK DEPOSIT INSURANCE

State money transmitter laws offer little protection to cardholders if the card issuer defaults

State	Surety Bond Requirement Range		Matching Investment Requirements	
	Low	High	Required/ Not Required	Permissible National Ratings Agency Grade
Alabama	$10,000	$50,000	Not Required	—
Alaska	$25,000	$500,000	Required	Top 3 Ratings
Arizona	$25,000	$500,000	Required	Top 3 Ratings
Arkansas	$50,000	$1,000,000	Required	Top 3 Ratings
California	$750,000	$9,000,000	Required	Top 3 Ratings
Colorado	$250,000	$2,000,000	Required	Top 3 Ratings
Connecticut	$300,000	$1,000,000	Required	Not Specified
Delaware	$25,000	$250,000	Not Required	—
District of Columbia	$50,000	$250,000	Required	Top 3 Ratings
Florida	$50,000	$2,000,000	Required	Top 3 Ratings
Georgia	$150,000	$1,500,000	Required	Not Specified
Hawaii	$1,000	$500,000	Required	Top 3 Ratings
Idaho	$10,000	$500,000	Required	Top 3 Ratings
Illinois	$100,000	$2,000,000	Required	Top 3 Ratings
Indiana	$200,000	$300,000	Required	Top 3 Ratings
Iowa	$50,000	$300,000	Required	Top 3 Ratings
Kansas	$200,000	$500,000	Required	Top 3 Ratings
Kentucky	$500,000	$5,000,000	Required	Top 3 Ratings
Louisiana	$25,000	$1,000,000	Required	Not Specified
Maine	$100,000	$100,000	Not Required	—
Maryland	$150,000	$1,000,000	Required	Not Specified
Massachusetts	$100,000	$100,000	Not Required	—
Michigan	$500,000	$1,500,000	Required	Top 3 Ratings
Minnesota	$25,000	$250,000	Required	Top 3 Ratings
Mississippi	$25,000	$500,000	Required	Top 3 Ratings
Missouri	$100,000	$1,000,000	Required	Not Specified
Montana	Not Required	Not Required	Not Required	—
Nebraska	$100,000	$250,000	Not Required	—
Nevada	$10,000	$250,000	Required	Not Specified
New Hampshire	$100,000	$100,000	Not Required	—
New Jersey	$25,000	$1,000,000	Required	Top 3 Ratings
New Mexico	Not Required	Not Required	Not Required	—
New York	$500,000	$500,000	Required	Top 3 Ratings
North Carolina	$150,000	$250,000	Required	Top 3 Ratings
North Dakota	$150,000	$150,000	Required	Top 3 Ratings
Ohio	$300,000	$2,000,000	Required	Top 3 Ratings
Oklahoma	$50,000	$1,000,000	Required	Top 3 Ratings
Oregon	$25,000	$150,000	Required	Top 3 Ratings
Pennsylvania	$1,000,000	$2,000,000	Not Required	—
Rhode Island	$50,000	$150,000	Not Required	—
South Carolina	Not Required	Not Required	Not Required	—
South Dakota	$100,000	$500,000	Required	Top 3 Ratings
Tennessee	$50,000	$800,000	Required	Top 3 Ratings
Texas	$300,000	$2,000,000	Required	Top 3 Ratings
Utah	$50,000	$50,000	Not Required	—
Vermont	$100,000	$2,000,000	Required	Top 3 Ratings
Virginia	$25,000	$1,000,000	Required	Top 3 Ratings
Washington	$10,000	$1,000,000	Required	Top 3 Ratings
West Virginia	$100,000	$1,000,000	Not Required	—
Wisconsin	$10,000	$300,000	Required	Not Specified
Wyoming	$10,000	$500,000	Required	Top 4 Ratings

SOURCE: The Pew Charitable Trusts, 2013

purpose reloadable prepaid cards was practically nonexistent.[10] These products, with features that mimic those of checking accounts, are relatively new to the marketplace.

While a money transmitter may have to hold investments meant to provide security to its customers, if the business fails and the investments that are held against debts are insufficient, the surety bond might be the only source of funds that customers can rely on to have their money returned.[11] In Alabama, for example, the maximum surety bond requirement is $50,000 and must be issued by a licensed bonding or insurance company. If a money transmitter were to default on its obligations, all affected parties would be required to submit claims, and the payout, which would likely not be immediate as it is with the FDIC, could be limited to $50,000 for all claims.

Alabama law does not provide for any process to streamline claims so that affected parties, such as these prepaid cardholders, would have easy or quick access to their funds. Without a streamlined process, consumers must navigate the normal legal process in order to receive their funds. This means that cardholders might have to wait several months for the completion of a bankruptcy proceeding before having access to the funds on their cards, if they get access at all.[12] In contrast, a consumer account with FDIC coverage, not only provides insurance to customers should a bank fail but also works to ensure that customers at a failed bank have a seamless transition to a new bank, with no difficulties accessing their funds.

Given that the market for general purpose reloadable prepaid cards is expected to grow by 42 percent per year from 2010 to 2014, mandating this type of insurance guarantees that consumers have coverage with easy and quick access to their funds and will allow these cards to compete as substitute checking accounts on a level playing field.[13]

American Express, which currently holds almost $20 billion in cash, might appear well positioned to prevent consumer losses in its prepaid card business.[14] But this does not mean it will always have such a surplus. Nor is there guarantee that any other company that avoids the use of FDIC insurance by taking deposits as a money transmitter will safely hold consumer funds.

As the prepaid card market continues to grow and consumers increasingly rely on these cards to deposit and manage their money, basic consumer protections need to be included. Failure to protect consumers by ensuring that they have safe and convenient access to their deposits puts them at risk. It also puts the public's faith in financial products at risk.

Policymakers should establish a level playing field for all deposit products that protects consumers rather than allowing companies to choose less-stringent regulations that could harm the development of a competitive and fair marketplace

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Endnotes

1 The Pew Charitable Trusts, *Loaded with Uncertainty: Are Prepaid Cards a Smart Alternative to Checking Accounts?* September 2012, available at: http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Prepaid_Checking_report.pdf.

2 Treasury rules permit federal payments to prepaid cards only if the funds are held in federally insured accounts. Financial Management Service Requirements, 31 C.F.R. § 210.5(b)(5)(i)(A), 2012.

3 Mercator Advisory Group, *Prepaid Market Forecast, 2011-2014*, November 2011. These cards include American Express for Target Card, American Express Prepaid Card, Pass from American Express Prepaid Card, and Bluebird by American Express.

4 Webpage of American Express, available at https://www.americanexpress.com/us/content/prepaid/state-licensing.html.

5 *Black's Law Dictionary*, 9th ed. (New York: West, 2009).

6 E.g. N.C. Gen. Stat. § 53-208.8 (2012) (North Carolina's surety bond requirement is based on the number of locations within the state).

7 In 22 states and the District of Columbia, the law requires that a money transmitter hold permissible investments against all outstanding payment instruments in the United States, not just within its jurisdiction. E.g. Or. Rev. Stat. § 717.225 (2012).

8 This is not meant to be an exclusive statement. Most states have several independent criteria for permissible investments.

9 Rinearson, Judith, *Regulation of Electronic Stored Value Payment Products Issued by Non-banks Under State "Money Transmitter" Licensing Laws*, 58 Bus. Law. 317 (November 2002).

10 For example, Green Dot Financial Network started the first cash-excepting reload network in 2004. Press release of Green Dot Corporation (March 2009), available at https://www.moneypak.com/Content/pdf/20090325_01.pdf.

11 Ala. Code § 8-7-7 (2012).

12 See Administrative Office of the United States Courts, *Bankruptcy Basics* (November 2011), available at http://www.uscourts.gov/uscourts/FederalCourts/BankruptcyResources/bankbasics2011.pdf.

13 Mercator Advisory Group, *Prepaid Market Forecast*, November 2011.

14 American Express Company Earnings Conference Call (October 2012), available at http://ir.americanexpress.com/phoenix.zhtml?p=irol-eventDetails&c=64467&eventID=4842214.