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November 7, 2005

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, D.C. 20429
Attention: Comments/Legal ESS

Re: Definition of "Deposit"—Stored Value Cards
Second Proposed Rule
70 *Federal Register* 45571, August 8, 2005

The American Bankers Association ("ABA") is responding to the request of the Federal Deposit Insurance Corporation ("FDIC") for comments on its second proposed definition of "deposit" as it relates to funds at insured depository institutions underlying stored value cards. The ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country Many of our members offer various types of stored value or prepaid cards and, accordingly, are extremely concerned about the potential impact of this proposal on this emerging market.

Although ABA appreciates FDIC's careful efforts to determine which prepaid card structures give rise to "deposits" for purposes of the Federal Deposit Insurance Act ("FDIA"), we continue to reiterate our belief that the costs of regulation—incurred solely by banks and not by their non-bank competitors—in conjunction with thin product margins could stifle, if not eliminate, bank participation in this rapidly developing market.

Summary Conclusion

ABA urges FDIC to refrain from making broad regulatory determinations of whether funds underlying stored value or prepaid cards constitute "deposits" and let the market determine which kinds of stored value products warrant deposit insurance. ABA *continues* to believe strongly that treating all such funds as "deposits" would add costs that nonbank competitors do not incur and thereby could eliminate the business case for many of these products. Moreover, concerns about deposit insurance as a consumer protection issue are already being addressed by the market place.

Accordingly, ABA believes it is *imperative* that depository institutions and their customers be free to design stored value and prepaid card programs that are either insured or uninsured as particular needs dictate.

Background

1. ***First Proposed Rule***

On April 16, 2004, in response to the development of new types of stored value cards and systems, FDIC published the First Proposed Rule that recognized the existence of three types of stored value card systems. Under that proposal, funds held by a depository institution would be "deposits:"

- Unless the institution's account records indicated the funds belonged to multiple cardholders but no records or subaccounts reflecting owner interests existed; or
- For a time period during which the institution had an obligation to forward to or hold the funds for the sponsoring company; or
- When a sponsoring company places funds at an institution for the purpose of making payments on stored value cards issued by that company

The First Proposed Rule did not set forth specific rules for "payroll cards" or "gift cards." Nor did it set forth rules for determining whether the deposit or the cardholder is the insured party.

2. ***Second Proposed Rule***

In response to comments received by FDIC on the First Proposed Rule, the agency issued the Second Proposed Rule. Under this new proposal, FDIC has analogized stored value cards and other nontraditional access mechanisms that access funds held at a bank, to traditional access mechanisms such as checks and ATM cards. For example, the preamble to the proposal states that

> [A] stored value card is similar to a paper check. Both a card and a check serve as the means of transferring funds held at a bank. In both cases, the funds are delivered to merchants through a "clearing process." . . . If a particular stored value card may be used to make withdrawals from ATM machines, then the card is similar to an ordinary ATM card.[1]

Using this analogy, the new proposal would treat funds underlying stored value cards and other nontraditional access mechanisms exactly the same as FDIC's treatment of funds underlying traditional access mechanisms. Thus, if an institution holds funds received from an individual or entity that can be accessed by nontraditional access mechanisms, the proposal would treat these funds as deposits under the FDIA.[2]

The corollary to the proposed treatment of such funds as deposits is that FDIC's current deposit insurance rules would apply to funds that may be accessed by stored value cards or other nontraditional devices. Under those rules, deposited funds are actually owned by the party named on the records of the financial institution *unless* the account records indicate that the funds are being held for third parties *and* there are records of the interests in the account of each third party.

Discussion

ABA cannot support the Second Proposed Rule because we continue to believe that a determination by FDIC that all funds underlying stored value and prepaid cards are "deposits" is premature at this point. Although it may be appropriate that some products in this market, such as payroll cards, have the benefit of deposit insurance, there is no need for overarching regulation that would affect the broader market for stored value and prepaid card products. Moreover, to the extent the market is currently addressing this concern—as we believe is the case—there is no need for *any* new regulation at this time.

Of equal concern is ABA's strong belief that if such funds are treated as "deposits" it will add significant costs to bank-issued card products that competitors do not incur, thereby driving depository institutions out of some of these markets.

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[1] 70 *Federal Register* 45571 at 45574.

[2] By contrast, FDIC's proposal would not apply to cards that do *not* access funds at a bank. Thus, for example, subway fare cards would not be covered.

1. ***The Second Proposed Rule is premature.***

Although the market for stored value and prepaid cards certainly has grown significantly since FDIC issued General Counsel Opinion No. 8, it nonetheless remains a nascent market—one that is evolving rapidly. Prepaid cards have dramatically increased in popularity over the last several years; and with that popularity the types of product offerings has also expanded greatly, leading to a market that is anything but homogeneous.[3] To the contrary, payroll cards are at one end of the spectrum, involving identifiable and longer-term relationships with cardholders, while at the other end of the spectrum are gift cards that could be categorized as "throw-away" products once their value is used. In between these extremes are products with endless combinations of card features and functionality.[4]

From a policy perspective, the purposes for which the cards are issued may dictate whether deposit insurance coverage is appropriate. For example, payroll cards that provide a means for the unbanked and underbanked to access their wages provide significant benefits to employers, employees, and society as a whole. Employees benefit from having a safe and less expensive means of receiving their wages, and employers benefit from the cost savings of eliminating paper checks and reducing check fraud. In addition, given the longer-term relationships typically associated with payroll cards, employees may expect that their wages be insured if accessed through payroll cards, just as they would be if accessed through traditional deposit accounts. However, given that employers are currently requiring that payroll card programs be eligible for deposit insurance, *there is no need for regulation to duplicate that effort.*

2. ***All stored value and prepaid card products do not warrant deposit insurance.***

It is clear that the products at the different ends of the market spectrum pose entirely different public policy issues for the banking system. Payroll cards, with their enormous benefits for both unbanked and underbanked employees and their employers, may well warrant deposit insurance coverage. But that coverage comes with a cost—assessments and compliance costs that are not insignificant.

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[3] One of the biggest areas of market expansion has been in the area of gift cards which, according to a recent study by ABA and Boston-based Dove Consulting, now account for four percent of all in-store purchases, up from two percent in 2003. Consumers' use of gift/prepaid cards for at least one purchase per month in stores increased from 12 percent in 2003, to 32 percent in 2005. Twelve percent of consumers plan to use gift/prepaid cards more often over the next two years. *2005/2006 Study of Consumer Payment Preferences.*

[4] As new card products are developed in response to demand, it may not even be clear exactly what a "payroll" card is. For example, employers that have adopted payroll cards as their method of paying employee's wages may also decide that annual or other types of bonuses may be provided through a separate gift card. Does that gift card thereby become a payroll card? Alternatively, if a holiday cash gift is added to an employee's payroll card, does the gift become part of the employee's salary for purposes of federal or state wage and hour laws? Thus, in this arena where banking and employment law intersect, it may not be clear exactly which products are "payroll" cards for some time to come.

And, although the public policy benefits of having deposit insurance for payroll cards may outweigh the attendant regulatory costs, the same case cannot be made for bank-issued gift cards.

Thus, ABA strongly believes that funds underlying all of the types of stored value and prepaid cards cannot be lumped together indistinguishably. Rather, the fact that the spectrum of products is so wide and still growing rapidly, mitigates against regulation, albeit well-intentioned, that would apply to all categories of card products that access funds held in depository institutions.

Consumer expectations should also be a significant determinant of whether gift cards, analogous in many respects to paper gift certificates, should be insured. Typically, customers expect to treat such cards just like cash. If they lose a card, they don't expect it to be replaced, even if it is reloadable. Similarly, they don't expect to provide identifying information when purchasing a gift card, whether buying it from Starbucks, Borders Books, or a bank. And they may likely give it to an individual completely unknown to the card issuer.

3. ***Not all funds held by a bank need be treated as "deposits."***

Although in its Second Proposed Rule FDIC has greatly simplified the analysis for determining "deposit" status by analogizing nontraditional access mechanisms to traditional access mechanisms, the result remains the same as its First Proposed Rule: virtually all funds underlying stored value and prepaid cards would be "deposits" under the FDIA.

However, this result is not necessarily a foregone conclusion. Other bank product models currently exist in which funds held by an institution are not deemed to constitute "deposits." For example, an institution may accept funds for the sale of a product that gives rise to a contractual relationship and an executory contract without creating a deposit for the *purchaser*. This type of model may be more appropriate for some types of cards depending upon the purposes for which they are issued. For example, when an institution sells a substitute cashier's check or an American Express traveler's check, it receives money from the purchaser but that transaction does not create a deposit for the purchaser.

4. ***Unwarranted regulation exacerbates an already uneven playing field.***

ABA cannot express strongly enough our belief that if all funds underlying stored value and prepaid cards are treated as "deposits," depository institutions will face significant added costs for their bank-issued card products that competitors do not incur. These costs, we believe, could drive depository institutions out of some of these markets, such as the gift card market which has particularly thin profit margins.

As noted above, we believe that most employers are requiring that their payroll card programs be eligible for deposit insurance, either directly or pass-through. However, if funds underlying low-denomination prepaid gift cards are deemed to be “deposits” under the FDIA, depository institutions will have to pay assessments on those funds, while their nonbank competitors will not have to incur such costs.

In addition, depository institutions already incur other regulatory costs not borne by their competitors. For example, where depository institutions have information about the cardholders, the consensus is that they must comply with customer identification rules under section 312 of the USA Patriot Act.

If FDIC goes forward with the Second Proposed Rule, ABA is concerned that there is a real possibility that banks will be forced to exit the market for bank-issued gift cards just as that product is really beginning to catch on with consumers.

Finally, ABA reiterates its concern that although FDIC’s proposal applies only to the FDIA, there is nonetheless a significant risk that classifying stored value and prepaid card products as a “deposits” could be the first step on a slippery slope to the inappropriate application of other regulations to these cards. Consumer regulations are not promulgated in a vacuum, and the fact that FDIC’s proposal is limited to its own statute, may well be a distinction without a difference in the overall debate.

In the final analysis, ABA believes that as this market develops, some issuers and their customers may wish to have the card values insured, while others may not. To remain viable, market participants need the flexibility to accommodate a variety of card features while controlling costs so that the products remain economically feasible. And, as discussed above, because the marketplace currently demands that payroll card products be eligible for deposit insurance, we see no need for any regulation at this time.

Questions Raised in the Proposal

FDIC has asked whether there should there be a *de minimis* exception from treatment as “deposits” for small denomination cards—*i.e.*, $100 or less—for anonymous cardholders. As discussed above, ABA believes that there is no need for a regulation at this time. Nonetheless, should FDIC determine to move forward, we believe that funds underlying payroll cards *only* should be treated as “deposits.”

ABA believes that FDIC should *not* prohibit institutions from accepting the funds underlying payroll, welfare or medical benefit cards unless they qualify for deposit insurance. The market is clearly differentiating between products such as payroll cards and gift cards by demanding that depository institutions ensure that payroll card products qualify for deposit insurance. In such cases, there is no question that the funds are "deposits" and are insured pursuant to FDIC's current pass-through rules. We believe that state benefit programs have similar requirements.

<u>Conclusion</u>

ABA cannot support the Second Proposed Rule because we continue to believe that a determination by FDIC that all funds underlying stored value and prepaid cards are "deposits" is premature. As discussed above, ABA believes it is *imperative* that depository institutions and their customers be free to design stored value and prepaid card programs that are either insured or uninsured as particular needs dictate. Depository institution participants in this market need the flexibility to accommodate a variety of card features while controlling costs—not incurred by their nonbank competitors—so that the products remain economically feasible.

This market is too important to have its development potentially impeded by regulatory restrictions until the need for such regulation, grounded on a thorough consideration of all relevant issues, has been clearly demonstrated.

If you have any questions about the foregoing comments, please contact the undersigned.

Sincerely,

Cristeena G. Naser

Cristeena G. Naser