

FinCEN Overhauls Stored Value Treatment Under the Bank Secrecy Act

On July 29, 2011, the Financial Crimes Enforcement Network (FinCEN) issued a final rule (Final Rule) that modifies the government's treatment of stored value, prepaid cards, and other prepaid access products under the Bank Secrecy Act (BSA) regulations. The Final Rule replaces FinCEN's current construct of treating "issuers and redeemers" of stored value separately from other Money Service Businesses (MSBs) with one in which "providers" and "sellers" of "prepaid access" are subject to BSA requirements. The nuanced definitions given to these terms in the Final Rule will require participants in the prepaid area to analyze carefully their activities to determine their formal role in the process. Most notably, under the Final Rule, "providers" of prepaid access will be responsible for suspicious-activity monitoring and reporting, as well as for other registration, customer identification, and recordkeeping activities. "Sellers" of prepaid access will share in each of these requirements, except for the registration requirement, for which the provider will retain sole responsibility.

The Final Rule covers prepaid devices such as plastic cards, mobile phones, electronic serial numbers, key fobs, and other mechanisms that provide access to funds that have been paid for in advance and are retrievable and transferable by replacing the term "stored value" with the term "prepaid access." The Final Rule is effective on September 27, 2011, except that providers of prepaid access have until January 29, 2012 to register as MSBs. Although the latter deadline provides ample time for registration, the earlier deadline creates a very compressed timeline for implementing the remaining requirements of the Final Rule, which may prompt providers of prepaid access products to suspend sales until an appropriate compliance framework can be implemented.

FinCEN was required by the Credit Card Accountability Responsibility and Disclosure Act of 2009, also known as the CARD Act, to issue "regulations in final form implementing the Bank Secrecy Act, regarding the sale, issuance, redemption, or international transport of stored value, including stored value cards." FinCEN published a Notice of Proposed Rulemaking Definitions and Other Regulations Relating to Prepaid Access over a year ago on June 28, 2010 (Notice). The stated purpose of the Notice was to establish a more comprehensive regulatory regime over an industry in which technological advances

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had outpaced existing regulation. In the preamble to the Final Rule, FinCEN justified finalizing the rule and the new regulatory regime based on its belief that the prepaid access market has matured and now warrants regulation that is, at a minimum, commensurate with that imposed upon other MSBs, regardless of future innovations that may occur in this market.

Definitions

The Final Rule defines “prepaid access” to mean “[a]ccess to funds or the value of funds that have been paid in advance and can be retrieved or transferred at some point in the future through an electronic device or vehicle, such as a card, code, electronic serial number, mobile identification number, or personal identification number.” This definition goes well beyond simple cards and would encompass new technologies such as mobile payments, “e-wallets,” and other means of transferring funds that have yet to be invented. Such an expansive definition is consistent with FinCEN’s stated goal of drafting regulations that will remain relevant as the industry evolves.

While the Final Rule maintains aspects of the current US\$1,000 thresholds below which most BSA requirements do not apply, it creates a new top-to-bottom compliance framework for which a single entity—a “provider of prepaid access”—has primary responsibility. The Final Rule allows the participants in a prepaid access program to determine contractually who will serve as that provider. However, anticipating that there may be instances where the participants in a prepaid program fail to reach such an agreement, FinCEN retained a list of factors originally published in the Notice for purposes of identifying a “provider.” Thus, in the event that no participant in the prepaid program registers as the provider, FinCEN will identify a provider using the following five factors, which may indicate “principal oversight and control,” but none of which is dispositive on its own:

- organizing the prepaid program;
- setting the terms and conditions and determining that the terms have not been exceeded;

- determining the other businesses that will participate in the transaction chain underlying the prepaid access, which may include the issuing bank, the payment processor, or the distributor;
- controlling or directing the appropriate party to initiate, freeze, or terminate prepaid access; and
- engaging in activity that demonstrates oversight and control of the prepaid program.

It is unclear whether any penalties would apply in the event the parties fail to select a “provider” from among themselves and FinCEN is required to make the selection itself. However, a prepaid program that operates without a designated provider after January 29, 2012, potentially risks regulatory criticism for such lack of compliance, and at a minimum faces the prospect of having a provider unilaterally designated by FinCEN.

The Final Rule defines a “seller of prepaid access” as “[a]ny person that receives funds or the value of funds in exchange for an initial loading or subsequent loading of prepaid access if that person:

- (i) [s]ells prepaid access offered under a prepaid program that can be used before verification of customer identification...; or
- (ii) [s]ells prepaid access (including closed loop prepaid access) to funds that exceed \$10,000 to any person during any one day, and has not implemented policies and procedures reasonably adapted to prevent such a sale.”

It is important to note, as the Final Rule points out, that the first prong of this definition incorporates the concept of “prepaid program,” so that exclusions to the definition of “prepaid program,” explained below, will serve as an exemption from this definition as well. The second prong appears to provide a safe-harbor for those merchants who take appropriate steps to limit sales of prepaid access to US\$10,000 per day but who, despite such efforts, may inadvertently permit isolated sales in excess of US\$10,000.

The Final Rule states that FinCEN believes that typically sellers of prepaid access are “general purpose retailers such as pharmacies, convenience stores, supermarkets, discount stores or any of a number of other types of businesses offering a full spectrum of products” who as the party with the most “face-to-face purchaser contact” are “in the best position to collect customer identifying information.” FinCEN decided that it is appropriate to regulate sellers of prepaid access despite strong opposition in comments on the Notice. Commenters expressed concerns that implementation of the proposed rule would result in high compliance costs, customer service challenges, privacy and data security issues, conflicts with state laws, and stigmatization of the unbanked and underbanked population. However, looking to close a potential loophole in the BSA rules while seeking an acceptable middle ground, FinCEN implemented what it believed to be reasonable controls over sellers of prepaid access while providing avenues for exemption from such requirements. Going forward, such exemptions will undoubtedly guide industry participants in creating prepaid products so as to alleviate the burden on sellers to the greatest extent possible.

Compliance Requirements

Subject to certain exclusions, both providers and sellers of prepaid access are required by the Final Rule to file suspicious activity reports, collect and maintain customer and transaction information, and develop and maintain Anti-Money Laundering (AML) programs. Like the AML program requirements currently in place for banks, the AML program must at a minimum:

- contain policies and procedures reasonably designed to assure compliance with the BSA/AML rules;
- designate a person to assure day-to-day compliance with the BSA/AML rules;
- provide education and training concerning responsibilities under the program; and
- provide for independent review of the program.

The preamble to the Final Rule states that AML programs “must be sufficiently detailed with standards and criteria specified for how the information is to be accessed, collected, verified, and retained.” In addition, it states that the programs should also include provisions addressing communication to employees and training of any individuals or entities acting as agents.

Providers of prepaid access must retain access to identifying information for five years after the *last use* of the prepaid access. Sellers of prepaid access must retain such identifying information for five years from the date of the *sale* of the prepaid access.

Providers of prepaid access, but not sellers, must also register with FinCEN as MSBs. A provider of prepaid access must submit, as part of its registration and registration renewals, a complete list of the prepaid programs for which it serves as provider. The provider will be responsible for maintaining a list of its sellers, who, similar to many other agents of MSBs, do not have independent FinCEN registration requirements.

Banks and bank-centered prepaid programs, to which existing BSA regulations already apply, are not covered by the proposed regulations; however, the mere involvement of a bank in a prepaid access program—for example, in the capacity as the issuer of the prepaid card or the custodian of funds—would not automatically exempt the program from the Final Rule. Instead, the Final Rule envisions, in certain instances, a dual compliance framework for prepaid access programs, in which banks must comply with their BSA requirements at the same time that providers and sellers of prepaid access comply with their separate BSA obligations—potentially resulting in a duplication of efforts, such as the filing of multiple suspicious activity reports for the same transaction.

Exclusions

While most prepaid access products are covered by the Final Rule, a number of prepaid activities, because of their

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limited money-laundering risk, are excluded from the new BSA requirements. Specifically, an arrangement is not considered to be a prepaid program if:

- it provides closed loop prepaid access¹ in amounts of US\$2,000 or less on any day;
- it provides prepaid access *solely* to funds provided by a government agency; or
- it provides prepaid access *solely* to funds from pre-tax flexible spending arrangements for health care and dependent care expenses, or from Health Reimbursement Arrangements (as defined in 26 U.S.C. 105(b) and 125) for health care expenses.

Additionally, the following are not considered to be a prepaid program, provided that the arrangement does not permit (i) funds to be transmitted internationally, (ii) person-to-person payments, or (iii) loading additional funds from non-depository sources:

- prepaid access to employment benefits, incentives, wages, or salaries; or
- prepaid access to funds not to exceed US\$1,000 and from which not more than US\$1,000 can be initially or subsequently loaded or withdrawn on any day.

We note that the US\$1,000 exception from the definition of “prepaid program” is framed in terms of access to funds in a single day through a single access device, and not expressly in terms of sales to a single individual. Presumably, it is anticipated that providers of prepaid access will implement procedures designed to restrict sales of prepaid access to no more than US\$1,000 to a single person in a single day. To that end, sellers of prepaid access will likely be called upon to monitor compliance with the US\$1,000 limit so as to protect the exemption for all parties involved with the prepaid product. Above and beyond such provider-imposed monitoring obligations, sellers must also independently take steps to monitor sales of prepaid access to prevent triggering additional compliance responsibilities under the Final Rule. In particular, sellers must take reasonable steps to ensure that no single individual is permitted to purchase over

US\$10,000 in prepaid access in a single day, regardless of whether such prepaid access is part of a “prepaid program” or is subject to an exemption. Sophisticated sellers—large supermarkets, for example—may be expected to use existing systems, such as customer loyalty programs that already track purchases, to monitor and aggregate total purchases of prepaid access.

The changes made by the Final Rule have the potential to impact significantly the relationship among participants in the prepaid industry, as well as the products they sell. Industry participants should review their operations to determine the extent to which any revisions may be necessary to existing policies and procedures in light of the Final Rule. In addition, industry participants must assess their prepaid programs to determine who will become the “provider” for registration and other compliance purposes, lest FinCEN make the decision itself. In light of the compressed timeframes imposed by the Final Rule, it is important that such assessments commence promptly.

If you would like to discuss the Final Rule and its impact on your business, please contact your Arnold & Porter attorney or any of the individuals below.

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¹ This includes, for example, prepaid access redeemable at only a single merchant or a single shopping mall.