



Major Misconceptions About Network Branded Prepaid Cards and Money Laundering Risks

September 6, 2007

Network branded prepaid cards¹ are the fastest growing card-based financial product. One research organization estimates that approximately \$14.13 billion were loaded on to network branded prepaid cards in 2005, the last year for which data are available. The popularity of network branded prepaid cards is attributable to their ability to address cardholder needs in a variety of situations including healthcare, disaster relief operations, government benefit payments, and gifting. They also provide an alternative to less efficient payment methods for unbanked and underserved consumers.

Despite the many benefits of network branded prepaid cards, aspects of these products are misunderstood. This may be because organizations not typically associated with financial products are sometimes involved in the creation and distribution of network branded prepaid cards. For example, some network branded prepaid cards are available through non-traditional distribution channels such as supermarkets and drug stores.

Misconceptions about network branded prepaid cards, which have gained currency through repetition, have the potential to affect the industry negatively—particularly with respect to issues relating to money laundering risks. This document addresses several major misconceptions by providing factual information that supports a fair and accurate assessment of money laundering risks associated with network branded prepaid cards.

Key Facts about Network Branded Prepaid Cards

1. Network branded prepaid cards are issued by regulated banking institutions or other regulated organizations such as licensed money transmitters.
2. From a transaction perspective, network branded prepaid cards “ride the rails” of the payment brands (American Express, Discover, MasterCard, or Visa) and/or PIN-based EFT networks, so that security features, consumer protections, controls, and monitoring apply.
3. Funds are not stored “on” network branded prepaid cards. Virtually 100% of transactions are authorized online and in real time.
4. With the exception of low-value, non-reloadable, non-cash accessible gift cards, “anonymous” network branded prepaid cards are virtually non-existent in today’s environment.
5. In general practice, issuers conduct CIP or CIP-like procedures for higher value, reloadable, cash accessible cards *before* cards may be activated and used.

Introduction to Network Branded Prepaid Cards

Network branded prepaid cards (sometimes call “open-loop” or stored value cards) are a payment innovation that offer significant benefits compared to cash and checks, and sometimes provide a more

¹ Network branded prepaid cards are financial products that carry the brand mark of a card organization such as American Express, Discover, MasterCard, or Visa. Not all prepaid cards are “network branded” cards. Some cards, often referred to as “closed-loop” prepaid cards, are usable only for specific purposes or for specific services. Examples of closed-loop prepaid cards include gift cards sold by an individual retailer and usable only in that retailer’s stores, telephone calling cards that may be used only to pay for telephone calls, and transit cards that may be used only to pay for travel on a particular transit line.

There are many applications for network branded prepaid cards (see Exhibit B for further explanation). They can be tailored to meet cardholder needs in a variety of situations. Sample applications include gift, travel, payroll, healthcare, and government benefits.

appropriate payment option than debit or credit cards. Most importantly, network branded prepaid cards offer cardholders control, choice, and security in how they manage their finances and budget their money. Finally, network branded prepaid cards extend mainstream financial services to groups of consumers that may have been limited previously to operating in a cash-only environment.

Network branded prepaid cards look similar to debit and credit cards and, in fact, are similar in many respects. First and foremost, like debit and credit cards, network branded prepaid cards are **issued by financial institutions or other highly regulated organizations**. Network branded prepaid cards also “ride the rails” of the existing and time-tested debit/credit card and ATM processing systems, which means that they are subject to the same types of systems and operational safeguards as any other branded card product.

Unlike credit or debit cards, however, prepaid cards typically represent funds “paid in advance”—to be used at a later time to pay for purchases of goods and services. *Some* prepaid cards also enable cardholders to access cash, most often through ATMs.

Major Misconceptions about Network Branded Prepaid Cards and Money Laundering Risks

1. **Prepaid cards are unregulated or loosely regulated.** Every network branded prepaid card (i.e., those carrying the logo of American Express, Discover, MasterCard, or Visa) is issued by a highly regulated financial institution or other regulated organization. As such, network branded prepaid cards are subject to exam, review, and oversight. For example, the FFIEC BSA/AML Bank Examination Manual (July 2006) sets forth specific requirements for examining banks regarding their “electronic cash” products (which encompasses “stored value”) including OFAC screening, transaction testing, and monitoring for suspicious activity.

In addition, many prepaid card program managers and distributors, organizations that perform specific functions relating to processing or distributing network branded prepaid cards, are regulated by state banking departments as money transmitters or check sellers. As such, they also are subject to exam, review, and oversight. State regulators are increasingly requiring money transmitters to: (1) register as MSBs with FinCEN, (2) have AML policies that address customer due diligence, OFAC screening, and suspicious activity monitoring and (3) have independent reviews of their AML policies.

Altogether, there are approximately 50 laws/regulations that apply to network branded prepaid cards. The applicability of these laws/regulations depends on a number of factors including the charter of the financial institution issuer.

2. **Prepaid cards are “ideal” for money laundering.** Network branded prepaid cards are actually less useful for money laundering than many other payment products for the following reasons:
 - o The value associated with network branded prepaid cards issued in the United States consists of funds held in a bank account in the United States. These funds can—at any time—be frozen by the card issuer and/or forfeited entirely. Unlike “bearer instruments” or chip-based cards, where whoever holds the product also holds the value, network branded prepaid cards keep the value separate, making the products less attractive to criminals.
 - o All network branded prepaid cards are processed through an online system that requires electronic authorization from the payment network prior to completing a purchase transaction at the point of sale or obtaining cash from an ATM.² The system enables card issuers to decline an authorization and/or to cancel the ability to use a prepaid card. The ability of the card issuer to terminate a card’s usefulness, without requiring possession of the card, is critical—and is a feature not shared by most traditional payment products.

² In the United States, virtually all transactions over a relatively low dollar threshold are authorized online in real time. In isolated instances, such as a system malfunction, a transaction may be authorized based on established parameters. These parameters typically allow consumers access to a relatively small amount of cash and impose purchase limits. Once the system is restored, the “offline” transactions are uploaded to the host and become part of the cardholder’s transaction history.

The online system tracks and records every use of every network branded prepaid card. Unlike paper payment products (such as checks, travelers checks, money orders, and cash), network branded prepaid cards leave a traceable trail of use including place, time, date, amount, and often the nature of the transaction. This trail has already assisted law enforcement in tracking misuse of prepaid cards.

- If a network branded prepaid card issuer identifies unusual or suspicious activity, the card can be blocked from further use. Card programs routinely monitor card activity and, as appropriate, file suspicious activity reports (SARs) or notify law enforcement.
3. **Network branded prepaid cards can be both anonymous and permit ATM access, with liberal load limits or no limits on the amount of cash that can be accessed.** Today, “anonymous” (meaning that *no* identifying information is obtained from the purchaser and verified) network branded prepaid cards are limited to the gift or reward card category³ (although many network branded gift/reward cardholders are identified and verified as well). Such anonymous gift/reward cards have significant restrictions that minimize risk of misuse such as a relatively low maximum dollar value, no ability to access cash through ATMs, and no ability to load additional funds after the initial funds are depleted. In addition, some issuers restrict usage of anonymous cards to the United States.
 4. **Prepaid card issuers do not require Customer Identification Programs (CIP) nor OFAC screening for individual prepaid cardholders.** Reloadable, cash-accessible network branded prepaid cards are not available anonymously. Individuals purchasing such cards are routinely subject to CIP and OFAC screening, as required for financial institutions opening “accounts” under the Bank Secrecy Act. These verification and screening procedures are identical to those conducted when any online bank account is opened.
 5. **A consumer can use cash to purchase a high value, reloadable network branded prepaid card from a j-hook and use it anonymously.** When a consumer purchases a reloadable network branded prepaid card from a j-hook in a retail location, a process called “activation” is typically required before the cardholder may use the card for a purchase or to access cash.⁴ In other words, although the consumer may *purchase* the card without identity verification, he/she may not *use* the card until the identify verification process is complete. The activation process typically involves the cardholder telephoning the card issuing financial institution (or a specialized organization with which the issuer has contracted) and providing personal identification information. The financial institution then verifies various elements of customer information including name, address, Social Security Number, and/or date of birth using a third-party authentication system such as Experian, Lexis-Nexis, or Equifax--just as they would a bank account. The issuer also screens customers against the OFAC Specially Designated Nationals list. If the cardholder does not “pass” this process, the card is either not usable or not reloadable.



The Network Branded Prepaid Card Association (NBPCA) is a non-profit inter-industry trade association that supports the growth and success of network branded prepaid cards and represents the common interests of the many participants—including network brands, processors, financial institutions, program managers, distributors, and organizations that support these businesses—in this new and rapidly growing payments category. The NBPCA’s Working Groups drive the activities of the Association for its more than 35 members. For additional information, visit www.NBPCA.com.

³ It can be argued that a purchaser of a gift card who uses a check, credit/debit card, or direct debit to a bank account is not “anonymous” because his/her identity can be determined, if necessary.

⁴In some instances, “activation” is not required for a low-dollar card, until the first reload occurs.

Exhibit A

Frequently Asked Questions About Network Branded Prepaid Cards

Why would a consumer want a network branded prepaid card?

Network branded prepaid cards are trusted, flexible financial tools that give consumers new options to manage their money and take control of their finances.

Here's how:

- **Convenience.** Network branded prepaid cards may be used almost anywhere for any type of purchase and, if the cards provide ATM access, at millions of ATM locations. For example, if a network branded prepaid card is given as a gift, the recipient may purchase the item of his/her choice from *any* merchant that accepts that card brand.⁵ And, if an employer pays an employee using a network branded prepaid card, the employee has immediate access to his/her funds, avoiding the hassles and possible expense of visiting a financial institution or check cashing organization. In addition, network branded prepaid cards issued as part of healthcare plans can be used to pay co-pays at medical offices and pharmacies for approved purchases, giving cardholders immediate access to their healthcare funds and avoiding significant paperwork and reimbursement delays.
- **Safety and security.** The network brand mark on prepaid cards provides consumers with significant protections typically not available with closed-loop prepaid cards and definitely not available with cash. For example, if a network branded prepaid card is lost, it may be reissued, enabling the consumer to spend the remaining value on the card. And, even if the card is stolen and used without authorization, consumers can get their funds returned (provided that the card is registered so that the issuer can identify the cardholder).
- **Choice.** Network branded prepaid cards are extremely flexible and take many different forms to provide financial solutions and new options for consumers in all walks of life. These cards give consumers more *choice* in deciding how to budget their money, manage their spending, give gifts, pay bills, and conduct many other day-to-day activities. Consumers are never forced to use a network branded prepaid card over other options, but many choose to do so because of the convenience and safety and security they offer compared to paper-based options including cash and checks.

How are consumers protected when they use network branded prepaid cards?

Network branded prepaid cards offer all of the consumer protections of the brand they carry. This includes “zero liability” for lost or stolen cards used for unauthorized transactions, card replacement, and purchase dispute rights. Effective July 2007, payroll cards (as defined by the Federal Reserve) are covered by Regulation E, the regulation that extends consumer protection to electronic transactions.

What are some of the ways that network branded prepaid cards are used?

One of the most important features of network branded prepaid cards is their flexibility. There are many types of network branded prepaid cards, each designed to meet the needs of cardholders in ways that cash and checks can't match. Examples of network branded prepaid card applications include:

■ Consumer-Oriented Network Branded Prepaid Cards

Consumers purchase a card for their own use or to provide to a friend or relative:

- Gift
- Travel
- Youth/Teen
- General Purpose
- Remittance

⁵ Some limitations apply. For example, MasterCard- and Visa-branded prepaid cards are accepted by merchants that have chosen to accept those brands' debit products. In addition, some network branded prepaid cards may be used only for specific types of purchases, e.g., healthcare cards may only be used to purchase eligible products and services.

■ Business-Oriented Network Branded Prepaid Cards

Businesses can use network branded prepaid cards to create new solutions that enhance their customers' lives. Some of these solutions include:

- Payroll
- Incentive and Rebate
- Insurance Claims and Disaster Relief
- Employee Benefits (e.g., Health Care, Wellness, Transit)

■ Government-Oriented Network Branded Prepaid Cards

Federal and state governments are recognizing that cards can reduce distribution costs and systemic fraud and provide better service to benefits recipients. For example, more than 35 states participate in programs that deliver child support payments via a prepaid card:

- Government Benefits (e.g., Unemployment, Child Support, TANIF)
- FTC distribution of redress funds in the SkyBiz case



Who decides if a network branded prepaid card can be used for purchases and/or to get cash at ATMs?

Strictly speaking, the card “issuer” (always a financial institution or other highly regulated organization) determines the features and functionality of its network branded prepaid cards. That determination, however, is related to the purpose for which the card is issued. For example, gift cards typically do not offer ATM access, because their purpose is to give recipients the opportunity to purchase gifts of their choice at the merchant(s) of their choice. On the other hand, payroll cards almost always combine purchase and ATM capabilities, so that employees can use the card for activities such as buying groceries, paying bills, and getting cash for day-to-day expenses.

Is a stored value card the same as a prepaid card?

The terms are often used interchangeably and government, in particular, seems to favor the term “stored value.” To the industry, however, there is a distinction between the terms. “Stored value” generally refers to a specific type of prepaid card that actually “stores” the value of the funds on the card, i.e., on a computer microchip embedded in the card. The term “prepaid card” typically refers to a magnetic stripe card (like most credit and debit cards in circulation today). The magnetic stripe never stores the monetary value of the card; that information is stored in a “host” or central computer system. When a network branded prepaid card is used for a purchase, an electronic message is routed from the merchant terminal to the host computer, which checks the available card balance and sends an authorization or a decline to the merchant.

How big is the network branded prepaid card marketplace?

The actual size (or dollar value) of the network branded prepaid card marketplace is a matter of ongoing discussion among industry experts. And, the truth is that the difficulty of measuring the size of this emerging and diverse marketplace makes quantification difficult; even highly skilled payment systems researchers produce estimates with significant variations.

Mercator Advisory of Waltham, Massachusetts, one of the leading research firms that follows prepaid products, estimates that in 2005, the last year for which data were available, network branded prepaid loads (the monetary value added to cards) in the United States were approximately \$14.13 billion. Mercator also estimates that network branded prepaid load growth increased by 56.3 percent between 2004 and 2005, and that overall growth between 2005 and 2006 will likely once again exceed 50 percent—with some network branded prepaid card applications continuing to experience triple-digit growth.

Exhibit B

How Network Branded Prepaid Cards Provide Consumers with New Financial Solutions and Choice

Card issuers leverage the flexibility of network branded prepaid cards to create solutions that address many common consumer needs, offering a safe, easy-to-use alternative to paper-based products such as checks, cash, and even vouchers.

The following provides examples of a few of the more popular types of network branded prepaid cards and describes how they can make a positive impact on consumers' lives:

Network Branded Prepaid Card Application	How the Card Makes a Positive Impact on Consumers' Lives
Payroll	<p>Description: Replaces checks to pay wages to employees. Once the card is issued, wages are “loaded” to the card at the end of each pay period.</p> <p>How to Get One: Issued through employers to participating employees.</p> <p>Source of Funds: Employer.</p> <p>How Used: To make purchases, pay bills, and get cash.</p> <p>Benefits to Consumer: Immediate access to wages—no need to cash a check, avoids check cashing fees, funds are replaceable if card is lost/stolen, no need to withdraw full amount of pay at one time (safety consideration), access cash almost anywhere through ATMs, empowers consumers who may not be in the financial mainstream and offers prestige of a branded card. Cardholders may designate funds from other sources (for example, another employer or government benefits) to be credited to the payroll card.</p>
Healthcare	<p>Description: Provides a convenient way to access funds in healthcare plans (including Flexible Spending Accounts, Health Savings Accounts, and Health Reimbursement Arrangements).</p> <p>How to Get One: Issued by healthcare plan administrators or obtained through a third party by the consumer (depending on the type of the healthcare plan).</p> <p>Source of Funds: Through the employer or a third party, such as a financial institution administrator (depending on the plan).</p> <p>How Used: To pay for co-pays and services at medical facilities and at pharmacies for approved purchases.</p> <p>Benefits to Consumer: Provides easy access to healthcare funds, eliminates paperwork associated with filing claims, no waiting for reimbursement of co-pays, funds are replaceable if card is lost/stolen.</p>

Network Branded Prepaid Card Application	How the Card Makes a Positive Impact on Consumers' Lives
Gift	<p>Description: Offers purchasers a convenient-to-buy, flexible-amount gift option appropriate for any occasion and offers recipients the flexibility to choose the perfect gift from a wide array of merchants.</p> <p>How to Get One: Purchase on the Web, at retail stores, or financial institution branches.</p> <p>Source of Funds: Typically consumer.</p> <p>How Used: To purchase a gift of the recipient's choice at a wide array of merchants. Usually not reloadable and not useable at ATMs.</p> <p>Benefits to Card Purchaser: Easy to purchase, available in variable amounts, always the right gift.</p> <p>Benefits to Card Recipient: The choice to buy the "perfect gift" at <i>any</i> merchant that accepts the card brand, including Internet and mail order/telephone order merchants. No unwanted gifts or gift returns.</p>
Disaster Relief/Insurance	<p>Description: Gets emergency funds to disaster victims—fast.</p> <p>How to Get One: Issued by insurance companies, government agencies, and relief organizations.</p> <p>Source of Funds: Government, relief agency, insurance company.</p> <p>How Used: To pay for necessities in the aftermath of a disaster (e.g., natural disaster or house fire). May or may not provide ATM access.</p> <p>Benefits to Consumer: Immediate access to funds—no need to cash a check, may be issued on the spot, wide merchant acceptance, funds are replaceable if card is lost/stolen.</p>
General Purpose	<p>Description: A safe and convenient alternative to using cash and checks for everyday purchases and bill paying.</p> <p>How to Get One: Purchase on the Web, at retail stores, or financial institution branches.</p> <p>Source of Funds: Employer, government, consumer.</p> <p>How Used: To make purchases, pay bills, and get cash.</p> <p>Benefits to Consumer: Empowers consumers who may not be in the financial mainstream and offers acceptance/prestige of a branded card. Enables those limited by a cash-only lifestyle to carry funds safely and conveniently, pay bills, and access cash independently. May request employers and other sources of income (e.g., government benefits) to credit funds to the card.</p>

Network Branded Prepaid Card Application	How the Card Makes a Positive Impact on Consumers' Lives
Travel	<p>Description: A convenient way for consumers to carry vacation/travel funds.</p> <p>How to Get One: Purchase on the Web or at travel-related businesses and financial institution branches.</p> <p>Source of funds: Consumer.</p> <p>How Used: To pay for purchases at millions of participating merchants. Some cards may be used worldwide; some are limited to domestic use. Cards with ATM access may be used to access cash in the local currency.</p> <p>Benefits to Consumer: Safer than carrying cash, more convenient than carrying travelers checks, accepted almost everywhere, eliminates currency exchange hassles, offers favorable exchange rates.</p>
Incentive/Rebate	<p>Description: Businesses buy prepaid cards in bulk to distribute to employees as incentives or to customers as incentives or rebates.</p> <p>How to Get One: Businesses issue cards to consumers (customers and/or employees).</p> <p>Source of Funds: Business.</p> <p>How Used: To pay for purchases at millions of participating merchants.</p> <p>Benefits to Consumer: Funds are immediately available—no check to cash, usable at many merchant locations, less hassle than check rebate/incentive payment.</p>
Government	<p>Description: Federal and state governments distribute benefits (e.g., child support, unemployment insurance, TANIF) using a prepaid card rather than a check.</p> <p>How to Get One: Government distributes these to benefit recipients who elect to receive their benefits in card from, rather than direct deposit or a check. In some states, distribution of benefits by card is a requirement for some programs.</p> <p>Source of Funds: Government.</p> <p>How Used: To make purchases, pay bills, and get cash.</p> <p>Benefits to Consumer: Funds are immediately available—no check to cash, usable at many merchant locations, bill paying capabilities, keeps funds segregated for easy accountability (important in some child support situations).</p>