

Testimony of Lauren K. Saunders
Managing Attorney, National Consumer Law Center
on behalf of
National Consumer Law Center's low income clients
and
Americans for Financial Reform
Center for Responsible Lending
Consumer Action
Consumer Federation of America
Consumers Union
The Leadership Conference on Civil and Human Rights¹
on
Examining Issues in the Prepaid Card Market
before the
Committee on Banking, Housing, and Urban Affairs
Subcommittee on Financial Institutions and Consumer Protection
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Chairman Brown, Ranking Member Corker and Members of the Committee, thank you for the opportunity to testify about prepaid cards on behalf of the National Consumer Law Center's low-income clients. The prepaid card market is growing fast and has provided access to modern electronic payment systems for millions of consumers who have been shut out of or misused by the traditional banking system. However, prepaid cards fall into gaps in our consumer protection system and also present new issues not addressed by our regulatory framework.

Prepaid cards are a relatively new product and are continuing to develop. There are a number of unknowns, and we should not pass definitive judgment on the prepaid

¹ Organizational descriptions are attached.

card market as it exists today. Currently, too many prepaid cards have substandard protections, limited functionality, and problematic fee structures. Will they remain a second tier bank account or will regulators and the industry overcome those hurdles? Will banks use prepaid cards as an excuse to shed low balance customers and neglect their obligations to serve their entire communities? Or will prepaid cards both serve useful functions in their own right and be a helpful stepping stone to greater financial inclusion of the unbanked and underbanked?

We do not yet know the answers to these questions. The factors are complicated, but here are some barometers.

First, consumers must have the choice of payment systems and financial accounts with a range of functions that meet their needs. The banking system, and traditional bank accounts, must remain open to low balance consumers. Prepaid cards are still a very limited product.² For most consumers, a traditional bank or credit union product is still the best choice.³ But many banks have been shedding their less profitable customers, and they must not use prepaid cards as an excuse for pushing lower income or credit-impaired consumers out of checking accounts. Instead, banks must look to the prepaid card world for ideas about how to safely and efficiently serve these consumers.

Public agencies and employers must always give benefit recipients and employees the choice of direct deposit to an account of their own choosing *before* making payments

² For example, prepaid cards work well as a vehicle for receiving direct deposits, but few, if any, can accept deposits of paper checks, forcing consumers to continue to use check cashers for some types of checks. In addition, load fees make cash deposits uneconomical. Most cannot be used to make payments to persons or entities that cannot accept cards.

³ A common complaint about prepaid cards is that they do not help consumers build credit, but banks accounts do not either. However, bank accounts offer many more features and a relationship with an institution that offers a broader range of products.

on a prepaid card. That is the law, but six states are currently failing to offer direct deposit of unemployment compensation.⁴

For consumers who choose prepaid cards, regulators must be careful not to relegate prepaid cards to second class status or prevent them from being an access point to the financial mainstream. Unfortunately, recent regulations exempt prepaid cards from the interchange fee cap only if the cards' features are limited.⁵

Second, consumers must understand the cost and terms of their accounts.

Understanding is more than disclosure. Information must not only be provided, but done so in a clear and conspicuous manner that promotes actual awareness and understanding. Some prepaid cards do a better job of this than others but many fall short. Some providers disclose fees prominently on the outside of the package at retail locations and on their websites, but those are the exception. On websites in particular, fees tend to be buried several clicks away and in the fine print of terms and conditions.

Even when clearly disclosed, prepaid cards can have complicated fee schedules. Complex balkanized pricing can make it difficult to discern the overall cost of an account or to compare different cards.

All prepaid cards should display, prominently, a chart of fees (and other important terms). Researchers should explore a standardized price tag that reflects the average cost

⁴ The Electronic Funds Transfer Act prohibits any person, including a state, from “requir[ing] a consumer to establish an account for receipt of electronic fund transfers with a particular financial institution as a condition of employment or receipt of a government benefit.” 15 U.S.C. § 1693k(2). California, Indiana, Kansas, Maryland, Nevada and Wyoming require unemployed workers to have a prepaid card account with the bank that issues the state card as a condition of receiving unemployment benefits. Though funds may be transferred to a private account, there is a delay in receiving the funds. For more information on unemployment prepaid cards, see National Consumer Law Center, “Unemployment Prepaid Cards: States Can Deal Workers a Winning Hand By Discarding Junk Fees” (May 2011), available at <http://www.nclc.org/issues/unemployment-compensation-prepaid-cards.html>.

⁵ General use cards, if issued by a bank over \$10 billion, cannot have checks, electronic bill-payment features or transfers to other accounts – including linked savings. Government agency cards issued by large banks are not permitted to accept nongovernment funds loaded by the consumer, preventing those cards from being used to bring a more fully functional account to unbanked consumers.

of a card and gives consumers a simple benchmark for comparing cards with different structures, just as the APR provides a point of comparison for credit cards today.

Third, consumers' funds must be safe in the case of insolvency of any party involved with the card, be it the bank, the program manager or someone else. The FDIC has explained how prepaid card programs must be set up to ensure FDIC insurance payable to the consumer regardless of the size of the master account. Most prepaid cards follow the FDIC requirements, but there is no way for consumers to know if they do, and some may not.

However, not all prepaid cards are issued by banks or eligible for FDIC insurance. American Express's prepaid cards are issued by its Travel Related Services division and not its bank and do not have FDIC insurance or any other federal protection if AmEx were to become insolvent. State money transmitter laws apply, but the protection they afford varies from state to state and even in the best state does not guarantee that the consumer will not lose funds or have them locked up in a protracted bankruptcy proceeding. Though American Express appears to be stable, bigger companies have failed, and the AmEx model may also be copied by less venerable institutions.⁶

Regulators must insist that any general use reloadable prepaid card carry deposit insurance, especially (but not only) if the card is used for deposit of wages, benefits, or other income.⁷ Exceptions should be permitted, if at all, only for very limited balance cards that function more like gift cards.

⁶ The precedent of permitting a company to hold consumer funds in accounts that are not covered by deposit insurance also makes it easier for dangerous products to emerge in the mobile payment space.

⁷ Or, for prepaid cards issued by credit unions, the cards should carry equivalent share insurance from the National Credit Union Administration.

Fourth, consumers need protection from errors, unauthorized charges and disputes. The Electronic Funds Transfer Act and Regulation E provide rights for bank account debit cards, payroll cards, and non-needs tested government benefit cards, but not for other types of prepaid cards. Most prepaid cards voluntarily follow the Regulation E payroll card rules. But determining whether they do requires scrutinizing fine print for complicated legalese, and even then consumers' rights are not as strong or enforceable as they would be if they fell under Regulation E directly.

All prepaid cards should be covered by Regulation E. This includes virtual prepaid cards and equivalent mobile payment systems.

In addition, consumers with prepaid cards – as well as those who use bank account debit cards – should have chargeback rights if consumers have a dispute with a merchant, just as they do with credit cards. The likelihood of a problem with a purchase is no different than when the purchase is made with a credit card or with a debit or prepaid card, and consumers need the same ability to dispute a charge if they did not get what they paid for.

Fifth, consumers need ample, free and convenient access to account information and customer service. Consumers should have multiple free methods of determining their balances, viewing transaction information, asking questions and resolving issues with their accounts. Most prepaid cards are not provided through brick-and-mortar locations that offer access to a human being. Fees may be charged for telephone customer service, and the consumer must enter long strings of numbers and navigate multiple menus to get to a live agent. Cards are typically provided and marketed to lower income, underbanked consumers, and yet consumers are expected to monitor

their accounts online even if they do not have easy internet access or are not comfortable using computers or accessing sensitive information online. Many prepaid cards do not offer the option of signing up for paper statements at any price or charge high fees for doing so. Fees are even charged for simple balance inquiries at ATMs and accessing an automated customer service line.

Prepaid cards should not be a black box in the consumer's wallet. They are accounts, and consumers should be able, and encouraged, to monitor their accounts for fees, errors and unauthorized charges. Consumers accustomed to the cash world may have questions about how the cards work. Like any consumer, they need the ability to resolve the problems that can arise. Admittedly, the margins on prepaid cards are thin, and the industry has reasons for encouraging consumers to use lower cost channels. But consumers should not be nicked and dimed for seeking the information they need, or worse, be inhibited from doing so. Prepaid cards will remain a substandard form of account if the industry does not find ways to encourage consumers to actively engage with their accounts to get the information they need – and to view prepaid card accounts as accounts, not just as disposable gift cards.

Sixth, prepaid cards must not have unfair fees or tricks and traps. Not every fee is troubling. Prepaid cards provide a service, and providers are entitled to charge for that service.⁸ If pricing is simple enough to be understandable, consumers can decide if the value is worth the price.

But some types of fees are problematic. Penalty fees should be eliminated whenever possible. As we saw in the credit card market, providers have terrible

⁸ The exception is government payment cards and payroll cards. Those cards should be designed to be free to the consumer for routine usage.

incentives to trick consumers into making mistakes if penalty fees are any part of the profit model.⁹ Information and customer service fees, as discussed above, inhibit consumers from getting information they need to manage their accounts. Inactivity, monthly or other fees should also not be charged against a zero balance account, creating a debt for an account that the consumer may assume is empty and closed. Some cards also charge quite steep or unexpected fees for other reasons.

Beyond specific problematic fees, the industry must simplify, simplify, simplify and keep fees minimal and reasonable. The more fees a card has, the more chances for confusion and unhappy customers. The difference between in- and out-of-network ATM fees, and ATM fees v. ATM surcharges v. ATM balance inquiries, can be bewildering. Some fees associated with bill payment features are incomprehensible and quite steep. Providers should help consumers to understand the cost of the cards by eliminating all fees that are not necessary and giving consumers the choice of a monthly fee that covers routine usage and a pay-as-you-go model with a small number of fees for discrete services.

Prepaid cards also need to stay clear of the tricks that have plagued other types of accounts.

Seventh, it is essential that overdraft fees and embedded credit features be eliminated from prepaid cards. Overdraft fees are what have driven many consumers out of bank accounts and created the opportunity for prepaid cards. When and how small dollar credit should be provided, through separate credit accounts,¹⁰ is another

⁹ Ideally, penalty fees will be eliminated altogether. At most, they should cover the cost of the conduct and be coupled with active measures to assist the consumer from making the mistake again.

¹⁰ We do not categorically oppose linking prepaid cards to a separate, affordable credit account as long as there is no offset of the deposit account or mandatory electronic repayment. A discussion of alternatives to

conversation, but the security of deposit accounts should not be undermined by including dangerous embedded credit features.

Senator Brown, in your own State of Ohio, prepaid cards are being used by the payday lender CheckSmart to evade Ohio's payday loan laws through loans on prepaid cards issued by Florida-based Urban Trust Bank. They are doing the same thing in Arizona. Prepaid cards with credit features are all too easy to sell in payday stores where the loans are illegal, taking us back to the rent-a-bank days when banks loaned out their charters to payday lenders to use as a vehicle for preemption.

Congress already directed prepaid card issuers to eliminate overdraft fees by conditioning the interchange fee cap exemption on the absence of such fees. But that rule does not apply to banks under \$10 billion. The Treasury Department took an important step forward to protect prepaid cards by banning attached lines of credit or loan agreements on cards that accept direct deposit of federal payments.¹¹ Again, the rule does not apply to every card.

The very name "prepaid card" should mean what it says. Indeed, "no credit check needed" and "you can't spend more than you have" are common marketing refrains for prepaid cards. Banning overdraft fees and other embedded credit features on prepaid cards would prevent deceptive practices and confusion and make the cards a safe,

payday loans and the features of a genuine alternative can be found in National Consumer Law Center, "Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don't" (June 2010), available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf. The criteria are: 36% APR with fees, amortizing installment payments generally over 90 days, no offset or mandatory electronic repayment, and consideration of ability to pay. Every form of credit that we have seen on a prepaid card fails every one of these criteria.

¹¹ See 75 Fed. Reg. 80335 (Dec. 22, 2010). The interim rule has not yet been finalized. NCLC's comments suggesting ways to tighten the rule to prevent evasions are available at http://www.nclc.org/images/pdf/other_consumer_issues/exempt_public_benefits/prepaid-card-comments.pdf.

genuine alternative to bank accounts, deserving of the higher interchange fees they are entitled to charge.

The good news is that things are generally moving in the right direction. The choice of prepaid cards on the market has been expanding. Banks, with their wide ATM networks (and capacity to accept deposits of cash and checks), are entering the market, and the industry is working on innovations like remote deposit capture that will make prepaid card accounts more functional. Compliance with FDIC insurance rules and Regulation E is generally the market standard. New means of accessing account information, like automated text messages and smart phone apps, are becoming more common. On many cards, fees have been coming down and fee structures are being simplified (though not yet enough). Most cards do not have overdraft fees and, other than the CheckSmart card, other credit features are currently nonexistent.¹²

But there are always outliers, and problematic cards harm not only the consumers who use them but also the reputation of an industry that is still introducing itself to the public. As the prepaid card industry knows all too well, the general public perception of prepaid cards is quite negative. The industry will have to work hard to gain public trust.

Regulators can help both consumers and industry by leveling the playing field and establishing strong minimum standards. The industry should welcome thoughtful regulation to help bring prepaid cards into the financial mainstream and take them out of the shadow banking system where they are today.

Dialogue, like today's hearing, is critical. Thank you again for this opportunity to testify. I would be happy to answer your questions.

¹² The Office of Thrift Supervision's laudatory 2010 action in shutting down lines of credit that were unfair or deceptive helped send a useful message to the industry, as did the Treasury direct deposit rule. However, Russell Simmons has announced that he will be adding a credit feature to his card.

Attachment: Descriptions of Organizations

National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and policy advice on consumer law issues to attorneys, policymakers and consumer advocates across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws.

Americans for Financial Reform is a coalition of more than 250 national, state and local consumer, labor, investor, civil rights, community, small business, and senior citizen organizations that have come together to spearhead a campaign for real reform, fighting for a banking and financial system based on accountability, fairness and security.

Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund.

Consumer Action empowers underrepresented consumers nationwide to assert their rights in the marketplace and financially prosper through multilingual financial

education materials, community outreach, and grassroots “make your voice heard” advocacy.

Consumer Federation of America (CFA) is a nonprofit association of some 300 national, state, and local pro-consumer organizations created in 1968 to represent the consumer interest through research, advocacy, and education.

Consumers Union of United States, Inc., publisher of Consumer Reports, is a nonprofit membership organization chartered in 1936 to provide consumers with information, education, and counsel about goods, services, health and personal finance. Consumers Union's publications have a combined paid circulation of approximately 8.3 million. These publications regularly carry articles on Consumers Union's own product testing; on health, product safety, and marketplace economics; and on legislative, judicial, and regulatory actions that affect consumer welfare. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and services, fees, and noncommercial contributions and grants. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

The Leadership Conference on Civil and Human Rights is the nation's oldest and most diverse coalition of civil and human rights organizations. Founded in 1950 by Arnold Aronson, A. Philip Randolph, and Roy Wilkins, The Leadership Conference seeks to further the goal of equality under law through legislative advocacy and public education. The Leadership Conference consists of more than 210 national organizations representing persons of color, women, children, organized labor, persons with disabilities, the elderly, gays and lesbians, and major religious groups.