



# Point of view

Analyzing Strategic Regulatory Policy Shifts

**Americas FS Regulatory Center of Excellence**

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**Prepaid Financial Products – CFPB Final Rule and  
Current Regulatory Environment**

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# 1. Executive Summary

Prepaid financial products (hereafter referred to as “prepaid products”) are one of the fastest growing payment instruments in the United States with many types of businesses issuing some form of a prepaid product. The Consumer Financial Protection Bureau (CFPB) has published a final rule that amends existing consumer protection regulations under the Electronic Fund Transfer Act (EFTA) and the Truth in Lending Act (TILA) to account for prepaid products. As a result, the issuers of prepaid products will face new compliance requirements.

In particular, the issuers of prepaid products, typically including traditional financial institutions, nonbank financial technology (FinTech) companies<sup>1</sup>, department stores, and online merchants will be required to provide:

- Easy access to account information, error resolution rights, and fraud and lost card protection;
- Specific disclosures with standard, easy-to-understand information about the prepaid account;
- Credit protections, including “ability to pay” reviews, monthly statements, reasonable time to pay, and limits on fees; and

- Specific protections, including a thirty-day waiting period and a “wall between”<sup>2</sup> prepaid funds and credit repayments.

The prepaid products covered by the final rule includes traditional plastic payment cards as well as mobile and other electronic prepaid accounts that can store funds, including payroll cards, certain federal, state, and local government cards, student financial aid disbursement cards, tax refund cards, and peer to peer payment products. As such, the scope includes non-traditional and emerging innovative digital and mobile products and applications.

The final rule was issued on October 5, 2016 with an effective date of October 1, 2017.<sup>3</sup> However, in April 2017, the CFPB issued a final rule delaying the general effective date from October 1, 2017 to April 1, 2018.<sup>4</sup>

## 2. Compliance Management Challenges and Expectations

The CFPB’s final rules do not provide guidance regarding complaints by consumers related to the use of prepaid financial products or the applicability of the final rule to FinTech companies. These are challenges that financial institutions must address given the current regulatory uncertainty, high potential for consumer harm, and overall regulatory scrutiny in relation to consumer financial products.

### 2.1 Complaints

In October 2016, the CFPB released a Monthly Complaint Report that highlighted consumer complaints regarding prepaid products. As of October 1, 2016, the CFPB had handled approximately 6,000

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<sup>1</sup> Companies in the technology sector that use technology to make financial services more efficient or provide financial products and services traditionally provided by banks.

<sup>2</sup> The final rule indicates prepaid companies cannot automatically demand and take credit repayment whenever a prepaid account is next loaded with funds. Further prepaid companies cannot take funds loaded onto the

prepaid account to repay the credit when a bill is due unless the customer has opted to allow such repayment.

<sup>3</sup> See CFPB Press Release “CFPB Finalizes Strong Federal Protections for Prepaid Account Consumers”. Please see <http://www.consumerfinance.gov/about-us/newsroom/cfpb-finalizes-strong-federal-protections-prepaid-account-consumers/>

<sup>4</sup> 82 FR 18975

of these types of complaints.<sup>5</sup> Some of the most common complaints addressed consumers' difficulties with: 1) transactions appearing on their account which they did not recognize; 2) registering and using their cards after purchasing the prepaid product; and 3) experiencing prolonged investigation periods after submitting claims about stolen funds, preventing access to funds balances. Consumers also complained about lengthy delays in receiving credits on their accounts after notifying issuers of a fraudulent transaction.<sup>6</sup>

By emphasizing complaints related to prepaid financial products in the October 2016 Monthly Complaint Report, it can be assumed that the CFPB is concerned with consumer protection with regard to such products. Issuers of prepaid products need to enhance or create a second-line complaints reporting process for prepaid financial products. Then, using data analytics, issuers should conduct root cause analyses and ensure corrective and timely actions are taken to resolve consumer complaints. Additionally, first line controls should be enhanced or created to appropriately manage consumer complaints.

## 2.2 New Market Entrants

FinTech companies are operating at the forefront of the prepaid financial product market and many of them offer a wide range of popularly available prepaid products. In the summer of 2016, a leading FinTech firm attempted to have the CFPB modify the proposed rules.<sup>7</sup> The firm contended the proposed rule would make compliance expensive and unreasonable. In response, the CFPB issued the "Project Catalyst Report: Promoting Consumer Friendly Innovation" during October 2016 affirming FinTech companies should be held to the same rules and oversight as banks. The CFPB indicated FinTech companies can provide many of the same services which banks provide making it important for banks and nonbanks to be held to the same compliance standards and oversight. The CFPB also indicated FinTech firms should not provide products which are harmful, deceptive, and/or discriminatory to consumers.<sup>8</sup> As such, FinTech companies must be prepared for enhanced compliance requirements related to the provision of prepaid financial products, specifically regarding the ability of the consumer to repay any extension of credit and related fees. FinTech firms need to be proactive in enhancing their compliance programs to align with the emerging regulatory environment in relation to prepaid financial products.

# 3. New Provisions and Amendments

The final rule was implemented as the CFPB believed there were gaps in the existing Federal regulatory regimes, and in particular under the EFTA's implementing regulation, Regulation E,<sup>9</sup> which prevented certain prepaid products from providing full consumer protections. The new rule closes the loopholes in this market and ensures prepaid consumers are protected whether they are swiping a card, scanning their smartphone, or sending a payment. Highlights of the final rule are referenced below (refer to the Appendix for further details of the final rule):

## 3.1 Prepaid Protections

The new rule gives prepaid account consumers important protections under the EFTA, which are similar to those for checking account consumers. These protections include:

- Issuers of prepaid products may either provide periodic statements<sup>10</sup> or, alternatively, make statements available to the consumer by telephone, online, and in writing upon request.
- Issuers of prepaid products must investigate and resolve incidents in which a consumer has indicated

<sup>5</sup> From the period of November 2014 through January 2015 to November 2015 through January 2016, prepaid financial product complaints increased 62 percent.

<sup>6</sup> Bureau of Consumer Financial Protection, *Monthly Complaint Report Vol. 16*, available at <http://www.consumerfinance.gov/data-research/research-reports/monthly-complaint-report-vol-16/>

<sup>7</sup> McKendry, Ian. "Prepaid Card Firms Make Final Push to Change CFPB Rule" American Bankers. 25 Apr. 2016. <http://www.americanbanker.com/news/law-regulation/prepaid-card-firms-make-final-push-to-change-cfpb-rule-1080646-1.html>

<sup>8</sup> Project Catalyst Report: Promoting Consumer-Friendly Innovation" CFPB 25 Oct. 2016.

<http://www.consumerfinance.gov/data-research/research-reports/project-catalyst-report-promoting-consumer-friendly-innovation/>

<sup>9</sup> CFPB press release November 13, 2014, "CFPB Proposes Strong Federal Protections for Prepaid Products", available at <http://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-strong-federal-protections-for-prepaid-products>.

<sup>10</sup> When providing a periodic statement, the CFPB's final rule also requires issuers to provide summary totals of the fees they have assessed against the prepaid account on a monthly and annual basis.

unauthorized or fraudulent charges were made on their prepaid account.

- Issuers of prepaid products must provide protections for lost cards and unauthorized transactions.

### 3.2 Know Before You Owe

The final rules include new “Know Before You Owe” prepaid disclosures which provide consumers with standard, easy-to-understand information about their prepaid account. Under the final rule, prepaid consumers must be provided with a short and long form disclosure indicating the fees associated with the prepaid product prior to the consumer acquiring the prepaid product. Prepaid account issuers will also be required to post the prepaid account agreements on the issuer’s website.

### 3.3 Credit Protections

The CFPB’s amendment will provide protections for consumers using credit products related to prepaid accounts

that allow the consumer the option of spending more money than what has been deposited into the consumer’s prepaid account. Issuers of prepaid products will be required to:

- Verify consumers have the ability to repay the debt before offering credit or increasing a credit line related to a prepaid card.
- Provide consumers with a periodic statement detailing the consumers’ fees and, if applicable, the interest rate, what they have borrowed, how much they owe, and other key information about repaying the debt.
- Give the consumer at least 21 days to repay the debt before charging a late fee.
- Limit fee and interest charges to 25 percent of the credit limit during the first year of opening the account.

## 4. Considerations and Solutions

The final rule will increase the regulatory focus on prepaid product compliance. Prepaid product issuers will need to manage their compliance more effectively and efficiently while mitigating regulatory, financial, and operational risks associated with a tailored approach. Therefore, it is important for institutions to assess the design and effectiveness of their prepaid product compliance programs.

Compliance leaders can take several actions prior to the effective date of the final rule to enhance their compliance effectiveness and efficiency. KPMG’s Compliance Transformation framework, which consists of eight program components, provides compliance leaders a guide for efforts to enhance their organization’s compliance program architecture and build in flexibility to respond to the evolving regulatory expectations discussed in this Point of View. The components are grouped around elements to prevent, detect, and respond to regulatory risks. With regard to the prepaid cards final rules, compliance leaders could immediately begin to take the following actions:

### 4.1 Preventative Elements

#### Automated Process Enhancement and Reengineering:

Review the current business processes and identify those areas impacted by the rulemaking that can be automated. The final rules now require businesses to ensure, amongst other things: (1) fees for prepaid products do not exceed 25 percent of the credit limit; (2) provision of monthly billing statements; and (3) a 30 day waiting period prior to extending credit to a prepaid consumer. Automating business processes will increase the likelihood of timely and effective execution of key activities required by the new rule. Automation will also free staff time, allowing staff to dedicate more time to answering consumer questions and responding to consumer complaints.

**Roles and Responsibilities:** Ensure staff understand how their roles and responsibilities will change as a result of the final rule. The final rule imposes regulatory requirements on a



Exhibit 1: Compliance Transformation Wheel

fairly unregulated industry causing a large impact on the day-to-day operations carried out by staff. Providing staff with tailored and informative training will limit the risk of errors, such as not properly calculating a consumer's ability to pay, providing erroneous information regarding fees, or failing to provide a consumer with requested information.

**Development of Disclosures:** Creation and automation of the "Know Before You Owe" short and long form disclosures. The final rule now requires customers of prepaid products to be provided with standard, easy to understand disclosures consistent with the CFPB sample forms prior to entering into a prepaid agreement. The development and implementation of new disclosures may increase short-term costs to draft and deliver the same to consumers. Further, the appropriate staff will need to be educated on the new requirements to address compliance requirements and increased inquiry rates from consumers regarding prepaid products.

## 4.2 Detective Elements

**Complaint Reporting:** Develop a complaint reporting and analysis process to 1) identify potential issues and 2) report and correct misconduct. To avoid reputational and financial harm companies should create an automated reporting and analysis process to identify complaint trends and root causes of systemic breaks. This may prevent repetitive instances of complaints and increase the overall customer experience.

**Reporting and Data Analytics:** Implementing data analytics to, among other operations, identify and investigate fraudulent and unauthorized charges. The final rule limits a consumer's liability for fraudulent transactions to \$50; starting on the effective date, fraudulent transactions above that threshold will result in a transfer of liability to prepaid issuers for covering fraud costs, provided the consumer provides timely notice. To avoid or limit this cost increase, companies should consider transactional testing and monitoring programs to help identify data anomalies and predict patterns in regard to prepaid errors, complaints, and trends.

**Compliance Monitoring and Testing:** Development of compliance monitoring and testing programs to confirm adherence to the final rule and identification of new risks created by the implementation of new processes to respond to the final rule. The final rule fills a gap in a marketplace that has not seen as much regulatory activity as other financial products. Compliance efforts may be significant, but will likely impact non-traditional financial institutions and FinTechs to a greater degree as they adjust to new oversight from the Bureau.

## 4.3 Responsive Elements

**Addressing changes to regulatory obligations:** Develop new business processes including policies and procedures to respond to new regulatory obligations, such as addressing customer's prepaid product requests for account information

through multiple communication channels. The final rule now requires account information to be easily accessible through multiple forums, including by telephone, online, and in writing. Using a central repository tool to store regulatory obligations and link the obligations to risks and controls within the company provides a more robust testing and monitoring function.

Additionally, based on the industry's shift towards digitizing labor intensive processes, compliance leaders should consider incorporating digital labor as much as possible to support further automation of business processes. Specific applications in prepaid product industry include compliance monitoring and testing activities.

# Appendix

## Summary of the CFPB Prepaid Financial Products Final Rule<sup>11</sup>

The CFPB believed there were gaps in the existing Federal regulatory regimes, and in particular under the EFTA's implementing regulation, Regulation E,<sup>12</sup> which prevented certain prepaid products from providing full consumer protections. "Consumers are increasingly relying on prepaid products to make purchases and access funds, but they are not guaranteed the same protections or disclosures as traditional bank accounts," said CFPB Director Richard Cordray. The new rule closes the loopholes in this market and ensures prepaid consumers are protected whether they are swiping a card, scanning their smartphone, or sending a payment.

**Prepaid Protections** - The new rule gives prepaid account consumers important protections under the EFTA, which are similar to those for checking account consumers. These protections include:

- **Access to account information** – Issuers of prepaid products may either provide periodic statements<sup>13</sup> or, alternatively, make statements available to the consumer by telephone, online, and in writing upon request. The statements must make available:
  - The account balance, through a telephone line, online, or in writing upon request;
  - An electronic history of account transactions covering at least 18 months; and
  - A written history of account transaction covering at least 18 months upon request.
- **Error resolution rights** – Issuers of prepaid products must cooperate with consumers who find unauthorized or fraudulent charges on their accounts. Issuers must investigate and resolve these incidents in a timely way<sup>14</sup>, and, where appropriate, restore missing funds. Additionally, if the issuer cannot resolve the error in a timely manner, the issuer would be required to temporarily credit the disputed amount.
- **Protections for lost cards and unauthorized transactions** – The consumer receives protection against unauthorized, erroneous, and/or withdrawal transactions. The final rules also limit the consumer's responsibility for unauthorized charges to \$50 per transaction, provided the consumer notifies the issuer promptly.

**Know Before You Owe: Prepaid Fees** - The final rule includes new "Know Before You Owe" prepaid disclosures which provide consumers with standard, easy-to-understand information about their prepaid account. In particular, prepaid consumers must have access to:

- **Standard, easy-to-understand information upfront** – Financial institutions must make certain disclosures available to consumers before a consumer agrees to acquire a prepaid account. Whether oral, written, or electronic, issuers must provide these disclosures on each of two forms:
  - A short form highlighting key fees (e.g. periodic, per purchase, ATM withdrawal, cash reload, ATM balance inquiry, customer service, and inactivity) the CFPB believes consumers should understand prior to acquisition and a statement regarding linked overdraft credit features.
  - A long form setting forth all of the fees associated with the prepaid account and the conditions under which those fees could be imposed. The final rules provides an alternative timing regime for delivery of the long form disclosure for prepaid accounts acquired at retail locations and by telephone.
  - Publicly available card agreements - Prepaid account issuers must post prepaid account agreements on the issuer's website (or make them available upon request in limited circumstances) and submit those agreements to the CFPB for posting on a website maintained by the CFPB.

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<sup>11</sup> CFPB Finalizes Strong Federal Protections for Prepaid Account Consumers, available at <http://www.consumerfinance.gov/about-us/newsroom/cfpb-finalizes-strong-federal-protections-prepaid-account-consumers>.

<sup>12</sup> CFPB press release November 13, 2014, "CFPB Proposes Strong Federal Protections for Prepaid Products", available at <http://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-strong-federal-protections-for-prepaid-products>.

<sup>13</sup> When providing a periodic statement, the CFPB's final rule also requires issuers to provide summary totals of the fees they have assessed against the prepaid account on a monthly and annual basis.

<sup>14</sup> Based on the requirements prescribed by the final rules. Prepaid issuers will be required to follow the timing requirements prescribed by Regulation E for error resolution.



**Credit Protections** - The final rule includes requirements whereby consumers would be entitled to the same protections currently provided credit card consumers when they choose to use a credit product related to their prepaid account. These protections largely stem from the TILA and the Credit Card Accountability Responsibility and Disclosure Act of 2009 (commonly referred to as the CARD Act). The protections would also apply to prepaid credit products including:

- **Ability to pay** – Issuers of prepaid products will be required to verify that consumers have the ability to repay the debt before offering credit or increasing a credit line related to a prepaid card. Additionally, for consumers under the age of 21, the companies are required to assess these consumers' independent means to make the payment without considering the funds of a co-signer.
- **Monthly credit billing statement** - Providing consumers with a periodic statement not more often than once per month. This statement must detail the consumers' fees and, if applicable, the interest rate, what they have borrowed, how much they owe, and other key information about repaying the debt.
- **Reasonable time to pay and limits on late fees** – Consumers must be given at least 21 days to repay the debt before they are charged a late fee. Also, the late fees must be "reasonable and proportional" to the violation of the account terms in question.
- **Limited fee and interest charges** - Total fees for prepaid credit products cannot exceed 25 percent of the credit limit during the first year a credit account is open. Card issuers generally are prohibited from increasing the interest rate on an existing balance unless the cardholder has missed two consecutive payments. Card issuers may increase the interest rate prospectively on new purchases, but must generally give the consumer 45 days advance notice – during which time the consumer may cancel the credit account.

**Additional Protections** – The final rule also includes protections to ensure the prepaid account and the credit product are distinct from each other, such as a:

- **30-day waiting period** - Companies must wait thirty days after a consumer registers the prepaid account before they formally offer credit to the consumer.
- **Wall between prepaid funds and credit repayment** - Issuers may not:
  - Solicit a consumer to link a covered separate credit feature until at least 30 days after the issuance of the prepaid product;
  - Automatically demand and take credit repayment whenever a prepaid account is next loaded with funds;
  - Take funds loaded into the prepaid account to repay the credit when the bill is due unless the consumer has affirmatively opted in to allow such a repayment;
  - Take funds more frequently than once per calendar month; or
  - Require payment sooner than 21 days after the mailing of the periodic statement.

**Compliance Dates** – The final rule is effective on April 1, 2018. The requirement to submit prepaid account agreements to the Bureau is delayed until October 1, 2018. Issuers must submit all prepaid account agreements that they offer as of October 1, 2018 to the Bureau no later than October 31, 2018.<sup>15</sup>

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<sup>15</sup> Bureau of Consumer Financial Protection, Docket No. CFPB-2014-0031, Prepaid Accounts under the Electronic Fund Transfer Act (Regulation E) and the Truth In Lending Act (Regulation Z). Available at [http://files.consumerfinance.gov/f/documents/20161005\\_cfpb\\_Final\\_Rule\\_Prepaid\\_Accounts.pdf](http://files.consumerfinance.gov/f/documents/20161005_cfpb_Final_Rule_Prepaid_Accounts.pdf)



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