

**Update: Notice of FinCEN Proposed Rulemaking of
Bank Secrecy Act Regulations Relating to Prepaid Access (Stored Value) Programs**

A. Overview

On, June 28, 2010, the Financial Crimes Enforcement Network ("**FinCEN**") proposed to revise regulations promulgated under the Bank Secrecy Act in order to expand its coverage to a variety of participants in prepaid programs (the "**Proposed Rules**"). The Proposed Rules affect retailers, online companies, interactive gaming companies, as well as more traditional financial institutions. **FinCEN has solicited comments to the Proposed Rules, which must be submitted by August 27, 2010.**

The Proposed Rules apply to programs that involve "prepaid access," a term that replaces "stored value" in the existing regulations and that is defined in broad, technology-neutral terms. Notably, prepaid access programs include a broader range of "open loop" programs than previously covered, as well as certain types of "closed loop" programs with international or peer-to-peer transfer functionality. Under the Proposed Rules, "providers" (such as program managers) and "sellers" (such as retailers) of prepaid access programs have substantial compliance obligations previously imposed only on financial institutions and certain types of money services businesses ("**MSBs**").

Under the Proposed Rules, providers and sellers would, among other things, be required to establish and maintain anti-money laundering programs that include Customer Identification Programs, file Suspicious Activity Reports, and meet new transaction recordkeeping requirements. In addition, providers of prepaid access programs would be required to register with FinCEN.

Beyond their application to typical open loop prepaid products, the Proposed Rules would also, for example, impose Customer Identification Program requirements, Suspicious Activity Report obligations, and registration requirements on:

- A retailer that offers its own closed loop gift card or electronic wallet program, if that program allows international purchase transactions or peer-to-peer transfer functionality;
- A retailer that sells third party closed loop gift cards that allows international purchase transactions or peer-to-peer transfer functionality;
- An online interactive entertainment company or retailer that provides open loop prepaid access under the new \$1,000 threshold (see below), but which allows international purchase transactions, peer-to-peer transfer functionality, or reloads through "non-depository" (i.e., non-bank) sources; and
- A retailer that sells or distributes third party prepaid cards with the features and functionality described above.

Additional information on the Proposed Rules is set forth below.

B. Background

Under current Bank Secrecy Act regulations, financial institutions and MSBs are subject to a wide range of anti-money laundering obligations. Among other things, they must establish anti-money laundering programs, file certain currency transaction reports and suspicious activity reports, and collect and maintain

certain customer information and transaction records. Most types of MSBs must also register with FinCEN. However, entities that are neither a financial institution nor an MSB but that are nevertheless involved in the management or sale of prepaid access currently are generally not subject to compliance obligations.

FinCEN has determined that prepaid access products (which can include a broad range of products, including gift cards, points and virtual "wallets") present opportunities for illicit activities such as money laundering and terrorist financing because they potentially allow large sums of money to be anonymously collected and transmitted. FinCEN intends to expand the application of the Bank Secrecy Act regulations to providers and sellers of prepaid access in order to limit such illicit activities. The Proposed Rules are mandated by the recently enacted Credit Card Accountability Responsibility and Disclosure Act of 2009.

C. Scope of Proposed Changes

The Proposed Rules expand coverage of the Bank Secrecy Act regulations to both providers and sellers of prepaid access programs.

Under the Proposed Rules, providers and sellers of covered prepaid access must each: (1) establish and maintain an anti-money laundering program that includes a customer identification program (obligation to collect, verify and retain name, date of birth, address and identification number from each person who obtains prepaid access); and (2) file Suspicious Activity Reports. In addition, providers must register with FinCEN and file with FinCEN a description of each prepaid program for which it is the provider of prepaid access.

The term "prepaid program" means an arrangement under which one or more persons act together to provide some type of prepaid access. The term "prepaid access" means an "electronic device or vehicle, such as a card, plate, code, number, electronic serial number, mobile identification number, personal identification number, or other instrument that provides a portal to funds or the value of funds that have been paid in advance and can be retrievable and transferable at some point in the future."

Providers are persons with "principal oversight and control over one or more prepaid programs." FinCEN has indicated that this will be a "matter of facts and circumstances" and that no single act or duty will be determinative. FinCEN will consider a variety of factors to determine which party is a "provider", including ascertaining which party is responsible for: (1) organizing the prepaid program; (2) setting the terms and conditions for the program and determining whether they have been violated; and (3) determining the other businesses (e.g., issuing bank) that will participate in the transaction chain.

Sellers are the party with the face-to-face relationship with the purchaser. Typically, this will be the retailer.

D. Exclusions and Exceptions to Exclusions

The Proposed Rules specifically exclude several categories of prepaid access programs that FinCEN believes present little risk of illicit activities. Prepaid access programs not subject to coverage include programs that involve the following:

- Payment of benefits, incentives, wages or salaries through payroll cards or other electronic devices for similar purposes;
- Payment of government benefits such as unemployment, child support and disaster assistance through electronic devices;
- Disbursement of reimbursement funds from pre-tax flexible spending accounts for health care dependent care expenses;

- Prepaid access to funds subject to the following limits where the maximum is clearly visible on the product: (a) \$1000 maximum value for an initial load; (b) \$1000 maximum aggregate value at any time during the product lifecycle; and (c) on any given day, no more than \$1000 can be withdrawn with the use of the prepaid access; and
- "Closed-loop" prepaid access products that can be used only in transactions involving a defined merchant or location (or a set of locations) such as a specific retailer or retail chain, a college campus, or a subway system.

However, to be eligible for the exceptions described above, the programs cannot: (1) be used to transfer funds internationally; (2) allow peer-to-peer transfers; and (3) unless it qualifies as "closed-loop", provide the ability to load monetary value from other non-depository sources.¹

¹ FinCEN's commentary on the perceived enhanced risk associated with these features includes the statements below. Additionally, FinCEN has advised that it intends to engage in future rulemaking regarding international transport of prepaid access.

"In this rulemaking, FinCEN proposes subjecting providers and sellers of closed loop prepaid access to BSA requirements in such circumstances that involve international use or person to person payments. Because financial transparency can be obscured, if the prepaid access product can be used internationally and other persons or non-depository sources can add or deplete the funds associated with it, FinCEN is proposing a regulatory construct under which certain providers and sellers of closed loop prepaid access would be subject to the BSA implementing rules. In several contexts, FinCEN has articulated the heightened money laundering and terrorist financing vulnerabilities associated with international transactions. The concern about international use is consistent with FinCEN's frequently repeated position that the specific geographic locations at which a financial product or service is offered must be taken into account in assessing the risks associated with that product or service..."

"We believe that this treatment is warranted given information provided by our law enforcement colleagues, maintained in a confidential docket, that closed loop gift cards have a strong appeal for criminal enterprises to launder cash proceeds in trade (merchandise). The criminals focus particularly on merchants who maintain retail locations both within and outside of the United States. The ability to redeem the value placed on the card on either side of the border is a convenient, anonymous method to move and masquerade illicit funds freely. The proposed rule would clarify that providers of prepaid closed loop access that can be used within and outside our borders are within the scope of BSA regulatory requirements." Amendment to the Bank Secrecy Act, 75 Fed. Reg. at 36,395.

"[a] closed-loop provider could be subject to the BSA implementing rules under this proposal if the prepaid access is no longer limited in range. A departure from current regulatory policy, this NPRM would subject a closed-loop provider to the BSA rules if the prepaid access product could be used internationally or if other persons and non-depository sources had access and could transfer the value of the funds."

"We believe that the characteristics cited under proposed 31 CFR 103.11(uu)(4)(ii)(B)(1)-(3),

- Funds or value transmitted internationally;
- Internal transfers within a program between individual cardholders; or
- For anything that does not qualify as closed-loop prepaid access, the ability to load funds or the value of funds from non-depository sources

allows for an element of anonymity that obscures the financial transparency necessary to ameliorate regulatory and law enforcement concerns. While not inherently suspect, the risks associated with these types of transactions diminish the clarity and audit trail that is generally found in payroll, flexible spending accounts, government benefits and closed loop systems."

"Additionally, inherent risk is associated with any international prepaid transaction simply because it involves governmental authority outside our domestic boundaries. The phrase 'international prepaid transaction' is intended to capture a domestic-issued prepaid product used outside of the United States. 'International prepaid transaction' could also

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include a foreign-issued prepaid product that is marketed or used in the United States. In such instance, the provider of prepaid access could be a foreign-located MSB subject to the BSA implementing rules."

"Our law enforcement stakeholders have warned of the potential use in an under-regulated environment of prepaid access products transported across our borders to effect high volume, high velocity movement of funds in a manner that may be extremely attractive to those engaged in criminal activity. Although not all international transactions involve criminal behavior, we believe that these transactions impose a level of risk that requires full BSA compliance, regardless of the type of prepaid program in which the provider is engaged." Amendment to the Bank Secrecy Act, 75 Fed. Reg. at 36,599--36,600.