



Consumer Federation of America

NATIONAL
CONSUMER LAW
CENTER

December 18, 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Regulation E: Electronic Fund Transfers, Federal Reserve Board
Docket No. R-1377

Dear Chairman Bernanke, Members of the Board, and Board Secretary Johnson:

Consumers Union, the nonprofit publisher of *Consumer Reports*®,¹ Consumer Action, Consumer Federation of America, and National Consumer Law Center, on behalf of its low-income clients, appreciate the opportunity to provide comment on this proposal which would amend Regulation E and implement statutory requirements from the Credit CARD Act of 2009. Our primary recommendation is that the Board use the additional power Congress gave it under the Credit CARD Act to restrict the size of gift card fees, set fees only on cards with small values and other consumer protections. The Credit CARD Act permits, but does not require the Board to restrict the size of gift card fees, and limit fees to cards with small balances. However, these additional steps are needed to preserve the value of gift cards.

The TowerGroup's most recent projection for the 2009 holiday season is an estimated \$87 to 91 billion in gift card purchases.² Of these gift card funds, millions of dollars remain unused on gift cards. The TowerGroup estimated that in 2006, approximately \$80 billion was spent to purchase gift cards.³ The same research firm

¹ 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 and services 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, noncommercial contributions and grants. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

² *No Holiday for Gift Cards: Store Cards Expected to Fall 7% as Buyers Face New Economic Realities, Weaker Inventories and Merchant Uncertainty*, TowerGroup Press Release, November 24, 2009.

³ *With Soaring Gift Card Sales Poised to Exceed \$80 billion in 2006, Unused Card Values Are Also on the Rise*, TowerGroup Press Release, November 20, 2006.

found that about \$8 billion remained unredeemed on gift cards in 2006.⁴ In addition, consumers' unused gift card funds are reported to be in the millions as revealed in retailer bankruptcy filings. For instance, the Sharper Image bankruptcy filings reported about \$20 million in unused gift card funds.⁵

The proposed regulation implements the mandatory gift card provisions of the Credit CARD Act.⁶ The Board should go further and use the discretionary authority Congress provided it to rein in fees that quickly diminish the prepaid value on gift cards and gift certificates, and expand other consumer protections to these products.

I. Summary

These proposed rules fall short in providing consumers with the assurance they need that they will not lose the value on their gift cards to unfavorable terms and conditions. We respectfully ask the Board to go beyond these proposed rules and to implement regulations for the following, all of which were authorized, although not required, by the Credit CARD Act:

- Determine caps on dormancy fees, inactivity charge or fees, or service fee amounts;
- Adopt a broad definition of “service fee;”
- Determine a cap on the type and amount of one-time fees;
- Establish a small value amount for when dormancy fees, inactivity charges or fees, or service fee amounts may be assessed;
- Adopt a broad definition of “activity” for purposes of measuring when a consumer’s gift card has been used;
- Make it clear and understandable to consumers that gift card funds do not expire earlier than 5 years;
- Include nonreloadable general use prepaid cards; and
- Extend EFTA protections to prepaid cards;

II. Determine the cap on the amount of dormancy fees, inactivity charges or fees, or service fees that may be assessed on gift cards, gift certificates or general pre-paid cards in Section 205.20(d).

The Board should establish a cap on dormancy fees, inactivity charges or fees, or service fees. Congress provided the Board with authority to determine the amount of dormancy fees, inactivity charges or fees, or service fees that may be assessed. These gift card provisions allow for one fee per calendar month, and this fee should only cover the costs to maintain a gift card or gift certificate without significantly eliminating the value in a short amount of time. For instance, a gift card with a \$50

⁴ *With Soaring Gift Card Sales Poised to Exceed \$80 billion in 2006, Unused Card Values Are Also on the Rise*, TowerGroup Press Release, November 20, 2006.

⁵ Sharper Image’s Motion to Honor Certain Prepetition Customer Programs, filed and entered on February 20, 2008, states approximately \$20 million on gift certificates, which includes Massage Chair Certificates, remained unredeemed at the date of filing.

⁶ Electronic Fund Transfers, 74 Fed. Reg 60986 (proposed rule).

value should not become worthless in a few months' time after the expiration of the 12-month no fee period.

States have long paved the way in improving gift cards for consumers. A number of states have eliminated fees altogether, including Minnesota, Montana, Florida, Illinois and Connecticut. Such legislation has encouraged major retailers to eliminate fees from their gift cards. The Board should follow the example of these improvements and utilize its authority to determine dormancy, inactivity and service fee amounts to best protect all consumers' unused gift card values.

a. The Board should adopt a broad definition of "service fee" in Section 205.20(d)(3)

We agree with the Board that the term "service fee" should include all transaction fees, reload fees and other types of fees associated with holding and using a gift card. The Board has the authority to interpret "service fee" in Section 205.20(a)(6) broadly, and should do so. Also, the Board should make it clear that any fees, including service fees, may be assessed no more frequently than once a calendar month, as set forth in Section 205.20(d)(3).

b. The Board should also determine a cap on the size and amount of any one-time fees in new EFTA Section 915(a)(3)(B)

While most fees fall under the dormancy, inactivity or service fee definitions, there may be a select few that do not. The Board should place a cap on the size and amount of one-time fees, such as issuance and cash-out fees. Congress has provided the Board with the authority to prescribe regulations to carry out these gift card provisions, and should thus ensure that any one-time fees are reasonable and that the amount is in proportion to a gift card's value.

III. Establish a small value amount for when dormancy fees, inactivity charges or fees, or service fees may be assessed on gift cards, gift certificates or general prepaid cards in Section 205.20(d).

The Board should adopt improved consumer protections to establish a small balance amount for when fees may begin to be assessed on gift cards and gift certificates. The Board should use its authority provided by Congress to determine "the amount of remaining value" for when dormancy fees, inactivity charges or fees, or service fees may be assessed on their gift cards, gift certificates and general use prepaid cards.

For those gift cards and gift certificates which may have fees assessed, states such as California, Oklahoma and Washington have taken an approach to limit fees by only permitting a \$1 fee when the balance of the gift card is \$5 or less. Such reasonable limits enable low balance gift cards and gift certificates to be taken off the books without penalizing consumers from losing much of their prepaid gift card funds. Going even further, a numbers of large retailers and nationwide chains have eliminated fees altogether as a result of stronger state legislation.

IV. The Board should adopt a broad definition of “activity” in Section 205.20(a)(5)

We agree that the Board should adopt a broad definition of “activity,” and should include all consumer efforts to use their gift cards. Since fees are assessed as stated in Section 205.20(d) when there is a lack of activity on a gift card, gift certificate or general use prepaid card, it is important to include in the definition of “activity” circumstances when consumers attempt to use their gift cards but are unsuccessful due to no fault of their own.

In response to the Board’s specific request to comment on what activities should be included for the purposes of Section 205.20(d)(1), we recommend the Board include attempted transactions which are unsuccessful or transactions which are not completed do to no fault of the consumers’. We have heard from consumers who could not redeem their card values when the merchant would not accept split-transactions or cannot determine the remaining amount on the card, when customer service does not respond or other circumstances which lead to failed transactions despite their attempts to use existing funds. Such transactions should be recorded by processors or reported to customer service and be accounted for as an “activity” to offset a dormancy period so that a consumer who is trying to resolve an operational problem with a gift card will not start incurring fees.

We have heard from too many frustrated consumers about the inability to use their gift cards. Bob from Arizona and Katherine from Pennsylvania help illustrate this frustration:

Bob: “The merchant was unable to tell me what balance remained on the card, making it very difficult to spend the last 10%. Also, the merchant could not take the remaining balance as partial payment and allow me to pay the remainder in cash. Thus, the last 10% was almost impossible to spend, which was very good for the card’s issuer but bad for the consumer (me)!”

Katherine: “There was a fee to activate it - and there was no way to tell how much was left - I still have it - it’s got \$2.00 and something left - hard to buy something with that amount and since I can’t tell how much there is it’s hard to use!”

By defining “activity” to include all circumstances that result in a failed transaction, consumers will be able to use the full value of their gift card. Usage issues that result from split transactions and other troublesome transaction issues that have prevented consumers from using their gift cards would be eliminated.

V. Consumers need to know that gift card funds do not expire earlier than 5 years

The Board should require that all gift cards, gift certificates and general use prepaid cards subject to an expiration date should not be sold unless the expiration date is at least five years from the date the card or certificate is sold or issued to the consumer. The intent behind these gift card provisions is for consumers to be able to use their gift card funds for at least five years from the date of purchase or

issuance. Since most consumers often rely on the imprinted date on the gift card or gift certificate, the expiration date must not reflect a date earlier than the five year period. Thus, it is important that gift cards with expiration dates have at least a five year expiration date from the time the card is sold or issued, and the Board should adopt Alternative A for Section 205.20(e)(1).⁷

We understand that there may be compliance issues and believe this may be alleviated by providing a compliance period for issuers and retailers to make it operationally feasible. For future gift cards and gift certificates, we suggest that that under the expiration date it reads for example, "Expires no sooner than 12/31/2015. Contact (800)xxx-xxxx for details."

Even after Alternative A to Section 205.20(e)(1) is adopted, we remain concerned that consumers will not be made aware that funds on a gift card will not expire until at least five years after the card is purchased or issued, particularly as the expiration date of the funds may be later than the date printed on the card. For instance, a consumer may load additional funds onto the card after a year, which would push the expiration date forward one more year and be in contrast with the imprinted expiration date.

Disclosures can be helpful but must be provided in a way that consumers, particularly the cardholders, will understand that funds have not expired when cards have earlier expiration dates. The disclosure should be provided on the gift card or gift certificate itself, along with a toll-free number for the consumer to contact for additional information.

Finally, when consumers need to redeem gift cards with the later expiration dates, they should not be required to repeatedly redeem their expired cards for new ones. For example, a consumer should not be required to make a request and obtain a new replacement card year after year. This would be burdensome and unnecessary. We also strongly agree with the Board that consumers should never incur a fee to obtain a card with a new expiration date, and also believe that one free replacement card should be provided to replace a lost or stolen gift card.

VI. The Board must ensure that Section 205.4(a)(1) provides clear and readily understandable disclosures to consumers both prior to purchase and during the validity of the gift card or gift certificate

The Board must ensure that disclosures are provided in a form and in a type of format so that gift cardholders will be able to readily access information regarding the gift card or gift certificate before and after purchase. Gift card or gift certificate recipients need to be able to easily access information on fees, expiration dates and other important terms and conditions throughout the validity of the cards' funds. This information must be provided clearly both prior to purchase as well as at a later date for the cardholder to easily access and understand.

⁷ Electronic Fund Transfers, 74 Fed. Reg at 60998 (proposed rule).

We would like to reiterate that providing consumers disclosures in electronic form will not suffice for consumers who do not readily have access to the internet. The issuers must provide staffed customer service lines to provide and address gift cardholders' questions accurately, particularly regarding remaining balances, expiration dates, and how to resolve issues with failed transactions, and must provide a feasible method to obtain the value on the gift card without incurring additional costs.

Stuart from California provides a good example of consumer confusion due to the lack of proper disclosure on gift cards:

"I have received them as gifts. They had monthly fees that were deducted from the amount on the card if you didn't use them by a certain date after they were purchased. However, being a gift, I didn't know when they were purchased and therefore were subject to the monthly fee."

VII. Nonreloadable general use bank account substitute prepaid cards should be covered under these gift card regulations

The Board should use the authority provided by Congress to include nonreloadable general use prepaid cards that are not marketed as gift cards or gift certificates under the exclusion in Section 205.20(b)(2). We recommend that the Board use its discretionary authority provided by Congress to carry out these gift card provisions, to waive any fees that may be attached to temporary nonreloadable general use bank account substitute prepaid cards until they are replaced by personalized reloadable cards.

While these cards are not intended to be used as gift cards, but rather act as and function more like bank account substitutes, there remains the high probability that consumers will remain confused between the differences between the cards and inadvertently purchase a nonreloadable bank account substitute prepaid card and not a true gift card. The Board even raises the possibility in these proposed regulations of nonreloadable bank account substitute prepaid cards from being displayed in the same rack as gift cards at retailers; thus being marketed as gift cards. Overall, to avoid any future noncompliance or circumvention of the Credit CARD Act's protections due to confusion, we recommend that nonreloadable cards that are not marketed as gift cards or gift certificates be covered under these gift card provisions to protect all consumers who purchase these products.

As we discuss further in the next section, general use prepaid cards which are used as bank account substitutes are a rapidly growing product and often come with numerous fees, hidden terms and conditions and other issues which need to be addressed by the Board.⁸

⁸ Michelle Jun, Prepaid Cards: Second-Tier Bank Account Substitutes (August 2009), can be found at <http://www.defendyourdollars.org/Prepaid%20WP.pdf>. Andrew Martin, Prepaid, but Not Prepared for Debit Card Fees, New York Times (October 6, 2009), can be found at <http://www.nytimes.com/2009/10/06/your-money/06prepay.html>.

VIII. The Board should finally extend Regulation E protections to prepaid cards

We request that the Board exercise the discretionary authority provided by Congress in the new EFTA Section 915(d)(2) to clarify that Regulation E covers general-use prepaid cards which many consumers use in lieu of debit cards linked to traditional bank accounts. The Board acknowledges the use of these cards as “an alternative to a bank account (or account substitute), such as for the unbanked.”⁹ These cards include self-arranged payroll cards and other types of cards which consumers use for day-to-day household needs. These general-use prepaid cards operate much like debit cards tied to traditional bank accounts, are often marketed as prepaid “debit” cards, and have the word “debit” on the cards.

For now, consumers with these cards are subject to voluntary protections which resemble Reg E protections.¹⁰ However, voluntary consumer protections are insufficient. For instance, general-use prepaid cardholders are subject to the whims of customer service representatives’ and their knowledge of the cards’ policies.¹¹ And, these terms and conditions can be revised and rescinded at any time, unlike regulatory and statutory guarantees such as those provided for debit cards under the Electronic Funds Transfer Act and Regulation E.¹²

General use prepaid cardholders should have the same regulatory and statutory protections against unauthorized transactions, and should be able to recover missing funds due to lost or stolen cards. They should also have other regulatory and statutory fraud protections, such as being able to recover missing money within a defined period of time. The Board’s authority to include general use prepaid cards under Regulation E protections will provide greater peace of mind to a growing number of consumers who rely on these cards to manage their household funds.¹³

⁹ Electronic Fund Transfers, 74 Fed. Reg. at 60993 (proposed rule).

¹⁰ The Bank Freedom Prepaid Debit Card is an example of a prepaid card that offers all of these features on the homepage at <http://www.bankfreedom.com/prepaid-debit-card.html>. However, the Definitions in the Terms and Conditions state that the card is a prepaid card and that “[t]he card allows you to access funds you place on the Card. The Card *does not constitute a checking, savings or other bank account* and is not connected in any way to any other account you may have. The Card is not a credit card. You will not receive any interest on your funds on the Card.” (emphasis added)

¹¹ “A voluntary policy is subject to the risk of uneven application and to the discretion of employees about how and when to apply the policy, which may disadvantage consumers whose primary language is not English, who are less able to spend time on the phone with customer service due to the nature of their jobs, or who are less able to write a persuasive letter describing the problems—in many cases, the very consumers to whom prepaid debit cards are being marketed as account substitutes.” Gail Hillebrand, *Before the Grand Re-thinking: Five Things to Do Today With Payments Law and Ten Principles to Guide New Payments Products and New Payments Law*, 83 CHI.-KENT L. REV. 769, 790 (2008).

¹² The Board has already extended Regulation E protections to one type of prepaid card, employer-arranged payroll cards. See Electronic Fund Transfers, 71 Fed. Reg. 51,437, 51,440-41 (Aug. 3, 2006) (codified at 12 C.F.R. § 205). The difference in protection is debit card holders are entitled to obtain monthly periodic statements when there is activity and quarterly when there is no activity. 12 C.F.R. § 205.9(b). Payroll cardholders do not receiving written periodic statements for free as long as the financial institution provides them with a way to obtain their balance by phone, online, or offers a written history. § 205.18(b).

¹³ Estimates vary from \$13.3 billion loaded onto prepaid cards in 2006 by the Federal Reserve to \$38.7 billion in 2007 by Mercator Advisory Group. Rachel Schneider, *The Industry Forecast for Prepaid Cards, 2009*, Center for Financial Services Innovation, 2009.

IX. Conclusion

We appreciate this opportunity to provide comment on the proposed rules on gift cards, and look forward to working with the Board to finalized rules that result in the strongest protection for consumers.

Sincerely,

A handwritten signature in black ink, appearing to read "Michelle Jun", with a long, sweeping horizontal line extending to the right.

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