

Financial Institutions Client Service Group

To: Our Clients and Friends

April 20, 2011

Federal Reserve Issues Clarification Regarding Definition of “Credit Card” -- Prepaid Cards That Access Lines of Credit Are Impacted

On March 18, 2011, the Federal Reserve Board of Governors issued a Supplementary Information and Final Regulation and Commentary (“Supplementary Information”) which, among other things, clarified the definition of credit card. The following Client Alert focuses on how the new Supplementary Information impacts debit and prepaid cards that access a separate line of credit.

Since publication of the February 2010 and June 2010 Final Rules, the Board has become aware that clarification is needed to resolve confusion regarding how institutions must comply with particular aspects of those rules. In order to provide guidance and

facilitate compliance with the final rules, the Board published proposed amendments to portions of the regulation and the accompanying staff commentary on November 2, 2010. See 75 FR 67458 (November 2010 Proposed Rule).

With respect to prepaid cards, the Supplementary Information discusses what happens when a customer opens a line of credit in connection with a prepaid card account. Depending on how the line of credit works, the prepaid card or prepaid card account number, or both, may be deemed a “credit card” under Reg Z. If the prepaid card or its account number is a credit card, then all Reg Z requirements applicable to a “credit card account under an open-end (not home-secured) plan” would apply to the credit transactions.

First Approach: If the customer can use the prepaid card or its account number to access the line of credit to pay for goods and services, then the prepaid card or account number, as applicable, will be deemed a credit card under Reg Z. This means that all Reg Z requirements applicable to credit cards (not home-secured) would apply. For example, the issuer of the prepaid card would be required to provide full Reg Z disclosures (including the Annual Percentage Rate) for the credit transactions, and

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payments for loans could not be debited without first billing the cardholder at least 21 days in advance of the payment due date or any grace period.

Second Approach: If the customer can use the prepaid account number simply to cause a transfer from the line of credit to load the prepaid card account, then that transaction does NOT convert the prepaid card or account number into a credit card. This means that you must still provide full disclosures of all terms and comply with other applicable state or federal laws, but the prepaid card or its account number is not subject to the full panoply of Reg Z's credit card rules.

Important: If a card issuer wishes to use the Second Approach to avoid characterization of a prepaid card as a credit card under Reg Z, it would be important NOT to combine the transfer of funds and any subsequent payment for a purchase into a "seamless" transaction. If, for example, a cardholder wishes to move \$72.50 to her prepaid card account in order pay for an online-purchase of goods, the card issuer should require the transaction to be made in two separate steps: first, the transfer of funds from the line of credit; second, the purchase of goods. Even better would be to have the initial transfer of funds from the line of credit to the prepaid card to be in a standard, flat amount (in our example, perhaps \$100), so that the two transactions (the transfer from the line of credit, and the purchase transaction) would be in different amounts as well.

If you have any questions, do not hesitate to contact us.

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