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OCC ADVISORY LETTER

Comptroller of the Currency
Administrator of National Banks

Subject: Payroll Card Systems

TO: Chief Executive Officers of All National Banks and National Bank Operating Subsidiaries, Department and Division Heads, and All Examining Personnel

PURPOSE

This advisory is in response to inquiries that the OCC has received from bankers and examiners regarding supervisory expectations for payroll card systems. Increasing numbers of national banks are offering payroll cards and other pre-paid payment services. The OCC has found that such activities are part of the business of banking.¹ General background information on this new product, which can be particularly useful for serving persons without bank accounts, can be found in an analysis prepared by the OCC Community Affairs Department.²

BACKGROUND

Payroll card systems can provide significant benefits for consumers (particularly for unbanked persons), but they can also present significant risks of consumer harm. The systems hold what are, for the individual consumers, important amounts of money – their payroll.³ A national bank should fully consider and appropriately address several important issues before offering payroll card products. These include compliance issues and any role of nonbank third parties. Failure to properly address these issues can expose the bank and its customers to significant risks.

There are a number of unsettled regulatory issues involving payroll cards including when FDIC deposit insurance is available to cardholders,⁴ whether Regulation E applies to payroll card systems, whether section 326 of the Patriot Act (verification of new customers) applies, and whether Regulation CC (Availability of Funds) applies.

¹ See, e.g., OCC Conditional Approval Letter No. 568 at <http://www.occ.treas.gov/interp/jan03/ca568.doc>

² “Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked” (Oct. 2003) at <http://www.occ.treas.gov/cdd/payrollcards.pdf>.

³ Although this paper focuses on payroll cards, it provides useful guidance with respect to other forms of stored value products such as gift cards. This guidance is consistent with the OCC Bulletin 96-48 on stored value cards, which the OCC is considering updating to address modern stored value products, including payroll and pre-paid gift cards that are reliant on host-based systems (e.g., on-line technology).

⁴ The FDIC recently published for comment a proposed rule addressing whether funds underlying stored value cards were “deposits” under the Federal Deposit Insurance Act and, thus, potentially eligible for deposit insurance. See 69 Fed. Reg. 20558 (April 16, 2004).

Another complicating factor is the role of nonbanks in payroll cards. Nonbank firms offering a payroll card product need bank participants to gain access to the payments systems. The involvement of nonbanks in payroll cards can significantly increase risks to cardholders and to banks if, for example, the nonbank should become insolvent.

GUIDANCE

While waiting for further guidance on the application of various laws and regulations to payroll card systems, banks may decide to comply with the substance of those laws and regulations to protect the bank against reputation risk and future compliance risk.

However, independent of these regulations, national banks engaged in payroll card systems should appropriately address the following important issues with respect to their system:

- Disclosure of material terms (including privacy policies and treatment of lost or stolen cards) and fees;⁵
- Disclosure of any costs to cardholder of accessing funds;
- Disclosure of risk exposures including absence of deposit insurance and potential bankruptcy of any third parties holding funds;
- Where and how the payroll card will be accepted and the funds accessed;⁶
- Error resolution procedures (including providing consumer access to funds during investigatory periods);
- Limits on consumer liability for unauthorized use including any exceptions or variations in these limits for ATM- or PIN-based transactions;
- Due diligence to confirm that employers are conforming with all applicable laws regarding their payroll card systems;⁷
- Appropriate verification of cardholder identity and other anti-money laundering controls; and
- Potential use of a payroll card system to support or facilitate abusive overdraft or “payday lending” programs.⁸

Proper attention to these matters will reduce the risk that the bank might directly or indirectly support unfair or deceptive practices in payroll systems by, for example, failing to make full, fair, and accurate disclosures of material matters. In this regard, banks engaged in payroll card systems should follow the guidance in OCC AL 2002-3 (March 22, 2002), “Guidance on Unfair and Deceptive Acts or Practices” at <http://www.occ.treas.gov/ftp/advisory/2002-3.doc>. The consequences of engaging in practices that are unfair or deceptive can include litigation, agency enforcement actions, and harm to the bank’s reputation. Banks engaged in payroll systems

⁵ Banks’ disclosures should enable consumers to understand how the payroll card product may present risks different from those of conventional payments products with which consumers are familiar such as credit or traditional debit cards.

⁶ Payroll card systems vary on the number of fee-free ATM transactions and in the fees for debit transactions.

⁷ Banks should check whether employers are compelling employee participation in a payroll card because such compulsion can be relevant to whether employee cardholders can avoid potentially unfair terms or practices.

⁸ Some issuers offer direct deposit payroll advance programs. These programs allow an employee to obtain an advance on pay that is repaid on the next payday.

involving nonbank third parties also should fully comply with OCC guidance on third-party relationships in their payroll card systems.⁹

OCC staff is available to work with banks that are considering involvement in payroll cards and can be reached through the national bank's examiner in charge.

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⁹ OCC Bulletin 2001-47 (Nov. 1, 2001) at <http://www.occ.treas.gov/ftp/bulletin/2001-47.doc>.