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MEMORANDUM

April 12, 2004

To Our Clients and Friends

Re: FDIC Proposed Rule on Whether Funds Underlying
Stored Value Cards Qualify as Insurable Deposits

The Federal Deposit Insurance Corporation (“FDIC”) has issued a proposed rule to clarify when funds underlying stored value cards will be treated as deposits under the Federal Deposit Insurance Act (“FDI Act”). Comments on the proposed rule are due 30 days after publication in the *Federal Register*.

PROPOSED RULE

In 1996 the FDIC published General Counsel’s Opinion No. 8 which identified four types of stored value card systems¹ and opined as to whether the funds underlying these systems were deposits within the meaning of the FDI Act. The FDIC is now proposing a rule to address deposit insurance coverage of the following stored value card systems² that have developed since 1996:

- Funds received from cardholders, or funds received from others on behalf of cardholders or for payment to cardholders, in exchange for stored value cards issued by the insured depository institution.

Funds received by such systems will be considered deposits unless the depository institution records its liabilities for such funds in an account representing multiple cardholders and maintains no supplemental records or subaccounts to reflect the amount owed to each cardholder.

¹ A stored value card is a device that enables the cardholder to transfer the underlying funds to a merchant at the merchant’s point of sale terminal.

² The proposed rule does not apply to gift cards offered by retailers in “closed systems.”

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- Funds received by an insured depository institution from cardholders in exchange for stored value cards issued by a sponsoring company.

Funds will be considered deposits if the depository institution is obligated to forward the funds to the sponsoring company or hold the funds for the sponsoring company. The funds cease to be deposits after they are forwarded or withdrawn.

Funds will not be considered deposits if the depository institution bears no obligation to forward the funds to, or hold the funds for, the sponsoring company.

- Funds placed at an insured depository institution by a sponsoring company for the purpose of making payments on stored value cards issued by the company are deposits.

This proposed rule is intended to address the treatment of deposits under the following types of stored value card systems.

- Accounts Funded by Sponsoring Companies – Under this system the cards are issued by a sponsoring company and not by the depository institution. The sponsoring company maintains an account at the depository institution to make payment on these cards. Under the proposed rule, the funds in the account maintained by the sponsoring company would be considered deposits as the account would be a commercial account and would be held for a special or specific purpose. Deposit insurance will pass through to cardholders only if the requirements for pass-through deposit insurance are satisfied.
- Pooled “Reserve Accounts” With Individual Subaccounts – An insured depository institution maintains a pooled self-described “reserve account” to maintain the funds received from all cardholders but also maintains a subaccount or balance with periodic subaccount statement for each cardholder. Under the proposed rule the funds in such systems would be considered deposits because an individual subaccount for a stored value card appears to qualify as a checking account and because the funds in the individual subaccounts are held for special or specific purposes.
- Payroll Cards – Under this system employers issue stored value cards to employees for payment of wages in lieu of issuing checks. Under the proposed rule funds underlying these payroll cards would be considered deposits unless 1) the issuer of the cards is the insured depository institution (and not the employer or other sponsoring company) and 2) the

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depository institution maintains a pooled “reserve account” but maintains no subaccounts or balances for individual cardholders.

The FDIC is also seeking comment on its definition of a stored value card, whether it should adopt special rules governing the insurance coverage of any deposits underlying stored value cards and whether it should mandate specific disclosures on the insurability of funds underlying stored value cards. (The FDIC had previously indicated that it expects depository institutions to clearly and conspicuously disclose the insured or noninsured status of stored value cards they offer to the public.)

The proposed rule can be found at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.