No. 06-2326

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

SPGGC, LLC; METABANK; U.S. BANK, N.A.,

Appellees and Plaintiffs,

v.

KELLY A. AYOTTE,
In her official capacity as
Attorney General for the State of New Hampshire,

Appellant and Defendant.

On Appeal from the United States District Court
For the District of New Hampshire
No. 1:04-CV-420-M

BRIEF *AMICUS CURIAE* OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY IN SUPPORT OF APPELLEE U.S. BANK, N.A.

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The Office of the Comptroller of the Currency ("OCC") respectfully submits this brief *amicus curiae* in support of appellee U.S. Bank, N.A., ("U.S. Bank"), which is a national banking association chartered under the National Bank Act, 12 U.S.C. § 1, *et seq.* Congress has charged the OCC with responsibility for interpreting and implementing the National Bank Act, administering the national bank charter, and determining the scope of permissible national bank activities, including their authority to provide new financial products and services.

Pursuant to its authority under federal law, the OCC has issued regulations making explicit national banks' powers to offer electronic stored value systems, including stored value cards, *see* 12 C.F.R. § 7.5002(a)(3), and to charge fees in connection with providing authorized products and services, *see* 12 C.F.R. § 7.4002. The OCC has specifically acknowledged national banks' authority to issue prepaid giftcards, and provided guidance to national banks and OCC examination personnel in connection with national banks' conduct of that authorized activity to help assure that consumers receiving giftcards have clear and ready information of the cards' key terms. OCC Bulletin 2006-34 (Gift Card

Disclosures (August 14, 2006)).[1] Under the National Bank Act, national banks may enter into agreements with third-parties to act as the banks' agents in carrying out authorized activities. 12 U.S.C. § 24(Seventh). U.S. Bank provides stored value cards to customers in New Hampshire pursuant to these federal authorizations.

The New Hampshire Consumer Protection Act, N.H. Rev. Stat. Ann. § 358A, deems a stored value card to be a "gift certificate" and prohibits the sale of stored value cards that do not comply with state law prohibiting certain fees and an expiration date for the giftcard. Plaintiff-Appellee U.S. Bank intervened in this action to obtain a declaration that these New Hampshire laws are preempted because they interfere with the bank's authority to conduct the business of banking as authorized by the National Bank Act.

As the supervisor of national banks and the national banking system, the OCC has a strong interest in assuring that national banks may engage in the business of banking to the full extent authorized by federal law. The state law at issue here interferes with the ability of U.S. Bank to offer bank products, namely giftcards, in New Hampshire in an efficient and commercially reasonable manner as authorized under federal law and, therefore, by operation of the Supremacy

[1] This document is included in the Appendix to this brief ("OCC App.") at

Clause

pages 1-4.

of the United States Constitution, it is preempted. Moreover, the Attorney General has asserted, erroneously, that OCC letters concerning a fundamentally different giftcard program support her argument that the New Hampshire statute is not preempted as applied in this case. The OCC submits this brief *amicus curiae* to address this confusion and present the federal interest at issue, which here coincides with the decision of the Court below that federal law authorizes national banks to use agents to sell their giftcards to the public, and that New Hampshire laws that interfere with national banks engaging in these authorized activities are preempted.

SUMMARY OF ARGUMENT

Congress granted national banks express and incidental powers to engage in the business of banking. These broad powers include the power to offer stored-value cards and the power to sell them to consumers using third-party agents. New Hampshire would prevent national banks from exercising these powers by prohibiting SPGGC—the third-party agent that U.S. Bank has engaged to promote, market, and perform ministerial acts necessary to deliver the bank's gift cards to the bank's customers—from carrying out these sales-related tasks. New Hampshire imposes this ban because the giftcards issued by the bank in accordance with its federally authorized powers have features that New Hampshire has determined to prohibit as a matter of state public policy.

A state law that conflicts with federal law is preempted. The Attorney General acknowledges that federal law authorizes U.S. Bank to sell its gift cards in New Hampshire even though the cards have features prohibited by state law. However, she argues that she avoids any conflict with federal law by targeting U.S. Bank's agent that performs essential duties in the sales process on behalf of the bank rather than the bank itself. According to the Attorney General, this tactic results in no conflict because U.S. Bank can change its conduct to use SPGGC as its agent in selling giftcards that do not have the features prohibited by New Hampshire law, or U.S. Bank can sell the giftcards directly to New Hampshire customers without relying on the services of a third party. The Attorney General's view of the permissible scope of state limitations on national banks' ability to engage in authorized activities is at odds with over one hundred years of Supreme Court precedent invalidating state laws that impair the exercise of national bank powers.

As authorized in the National Bank Act, the incidental powers of national banks include the power to conduct banking activities through agents appropriate for that purpose. Consequently, a New Hampshire statute that prohibits U.S. Bank's use of SPGGC as its agent for the sale of the bank's federally authorized giftcards is invalid by operation of the Supremacy Clause of the United States Constitution in the same way as any other state law that has the effect of banning U.S. Bank's use of a normal business tool in carrying out the business of banking.

The District Court correctly interpreted the laws at issue here and properly applied the consistent guidance of the Supreme Court in concluding that the National Bank Act preempts New Hampshire state laws that prevent U.S. Bank's sale of its giftcards using SPGGC as the bank's agent. That decision should be affirmed.

ARGUMENT

Drawing on decisions spanning the over 200 year history of federally chartered banks, the Supreme Court has explained how courts must view the application of state law limitations on powers granted national banks in the National Bank Act:

> In using the word "powers" the statute chooses a legal concept that, in the context of national bank legislation, has a history. That history is one of interpreting grants of both enumerated and incidental "powers" to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting contrary state law.

Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 34 (1996) ("*Barnett*").

Appellant tries to avoid application of these settled principles by arguing that

U.S. Bank's power to use agents in exercising its banking powers is subject to limitations imposed by the state based on the nature of the products and services the bank is offering through its agent. The application of the New Hampshire law in the manner urged by the Attorney General would prevent U.S. Bank from selling giftcards in an efficient and commercially reasonable manner authorized by federal law, thereby impermissibly interfering with U.S. Bank's power to offer giftcards to its customers.

I. FEDERAL LAW GRANTS U.S. BANK THE POWER TO OFFER GIFT CARDS TO CUSTOMERS AND TO USE THIRD PARTIES TO PROMOTE, MARKET AND PERFORM MINISTERIAL TASKS NECESSARY TO DELIVER GIFTCARDS TO THE BANK'S CUSTOMERS.

The statutory authority for national banks to conduct business comes from the National Bank Act, enacted in 1864. 12 U.S.C. § 1 *et seq*. In addition to setting forth the framework for the creation, regulation, and operation of national banks, the National Bank Act governs the scope of "banking powers" -- *i.e.*, statutorily-authorized banking-related activities. Those powers include the authority: "To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of title 62 of the Revised Statutes." 12 U.S.C. § 24(Seventh). This broad grant of power authorizes each of U.S. Bank's activities at issue here.

A. Offering Stored Value Cards is an Authorized Banking Activity Supervised by the OCC.

Emphasizing the broad scope of banking powers authorized under Section 24(Seventh), the Supreme Court has explained that, "[a]s the administrator charged with supervision of the National Bank Act * * * the Comptroller bears primary responsibility for surveillance of 'the business of banking' authorized by § 24 Seventh." *NationsBank of North Carolina, N.A., v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 256 (1995). And the Court has "expressly [held] that the 'business of banking' is not limited to the enumerated powers in § 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated." *Id.* at 258 n.2.

Pursuant to its authority under 12 U.S.C. § 93a, the Comptroller has issued regulations addressing national banks' authority to engage in the business of banking through electronic activities. *See* 12 C.F.R. Part 7, Subpart E. Those regulations provide that "a national bank may perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide or deliver, subject to [restrictions and conditions imposed by the OCC] and applicable OCC guidance." 12 C.F.R. § 7.5002(a). These regulations specifically authorize national banks to offer "electronic stored value systems." 12 C.F.R. § 7.5002(a)(3).

The giftcards issued by U.S. Bank are a type of stored value card that national banks are authorized to sell to their customers under the OCC's regulations.

1. *National Banks May Charge Fees in Connection With Providing Stored Value Cards to their Customers.*

It is a fundamental principle that the authority conferred by federal banking law to provide a banking service carries with it the authority to charge for that service. National banks are private, for-profit enterprises, and not public utilities or common carriers, which must justify service charges to regulators. National banks are charged in 12 U.S.C. 24 (Seventh) with the authority to engage in the "**business** of banking" (emphasis added), which cannot be separated from the authority to seek a business return from those activities. Any contrary rule would render national bank powers meaningless.

The OCC specifically addressed the authority of national banks to charge fees for the products and services they provide in a rule issued in 2001. *See* 12 C.F.R. § 7.4002. This regulation provides that "[a] national bank may charge its customers non-interest charges and fees, including deposit account service charges." 12 C.F.R. § 7.4002(a).[2]

In this case, U.S. Bank charges and receives all fees collected in connection with the sale and operation of its giftcards.[3] Declaration of John Focht in Support of U.S. Bank's Supplemental Briefing in Support of SPGGC, LLC's Motion for Summary Judgment. Appendix to the Brief of Kelly A. Ayotte ("Ayotte App.") at 230, 232. As explained above, these fees are collected pursuant to powers granted the bank under federal law.

2. National Banks May Impose Expiration Dates for Stored Value Cards.

In granting national banks the power to engage in the business of banking, federal law grants national banks the power to establish the terms and conditions that govern the products and services they offer, subject to the requirements of federal law. This is true of national bank lending products. *See, e.g., Smiley v.*

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[2] The regulation goes on to state that "[t]he establishment of non-interest charges and fees, their amounts, and the method of calculating them are business decisions to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles." 12 C.F.R. § 7.4002(b)(2). It also identifies factors bearing upon a bank's decision to establish a fee, including the cost of providing the service and deterring misuse of banking services. *Id.*

[3] The circumstances of U.S. Bank's assessment and collection of fees involved in its giftcard program with SPGGC are very different from the arrangements involved in a different giftcard program that was the subject of the January 5, 2005 letter from OCC Acting Chief Counsel, Daniel P. Stipano. Addendum to Appellant's Opening Brief at 60-61. This letter is discussed more fully below.

CitiBank (South Dakota) N.A., 571 U.S. 735 (1996) (federal authorization to charge late fees preempts contrary state law). It is true for national bank deposit-taking activities. *See, e.g., Wells Fargo Bank of Texas, N.A. v. James*, 321 F.3d 488 (5th Cir. 2003) (state law banning fee for paying check submitted at teller window preempted). It is true for national banking services. *See, e.g., Bank of America v. City and County of San Francisco*, 309 F.3d 551, 561-564 (9th Cir. 2002) (municipal ordinances banning ATM access fees preempted). Federal law similarly authorizes national banks to specify the terms and conditions that govern their giftcard products.

In offering any product or service, national banks must conduct the activity in accordance with safe and sound banking practice. *See, generally*, OCC Bulletin 96-48 (Sept. 10, 1996)[4], OCC App. at 14 ("Effective controls, audit coverage, and other preventive measures should be in place to deter or minimize the impact of fraud, counterfeiting, and other improper activities."). A common term included in giftcards issued by national banks and permitted under federal law is imposition of an expiration date for the card itself. Like the right to refuse to pay a stale check under the Uniform Commercial Code, U.C.C. § 4-404, *see also IPB, Inc. v. Mercantile Bank of Topeka*, 6 F.Supp.2d 1258, 1266 (D. Kan. 1998) (no obligation

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[4] OCC App. 5-16.

to pay a check more than six months after its date), this expiration date helps the issuing bank manage its obligation to make payments as directed by the holder of the card while reducing the risk of card fraud by imposing an express limit on the term during which the card may be used.

3. *OCC Guidance Instructs National Banks to Inform Consumers of the Essential Terms of National Bank Giftcard Products.*

As the supervisor the national banking system, the OCC is committed to assuring that consumers of giftcards issued by national banks are provided the information necessary for them to understand the key characteristics of the products they are purchasing and using. Thus, OCC guidance instructs national banks to provide disclosures about the key terms of the giftcard to consumers in ways that make that information accessible to the purchaser of the giftcard as well as the recipient. *See* OCC Bulletin 2006-34 (August 14, 2006), *supra*.

Specifically, OCC guidance provides that national banks should disclose the basic information that is most essential to a giftcard recipient's use of the card on the card itself, either by printing the information directly on the giftcard, or by including it on a label attached to the card. This information typically will include disclosures related to the amount or existence of any monthly maintenance, dormancy, usage or similar fee, the expiration date of the card, and information on how consumers may obtain additional information about their cards or other customer service related to the giftcard. *See id.*, OCC App. at 2.

In addition to disclosures the OCC has advised national banks to include on the giftcard itself, the OCC has identified other disclosures to be included with the giftcard, typically on a separate form. These additional disclosures normally would involve more detailed information about the particular giftcard, and would include, among other things, disclosure of:

- The name of the national bank that issued the card;
- Any fees (including those disclosed on the card itself) that may apply to the card, such as card replacement or reissuance fees, balance inquiry fees, foreign currency conversion fees, and cash redemption fees;
- Whether and how consumers can receive a replacement card in the event that their card is lost or stolen, the information that consumers need to retain in order to do so, and the consumer's responsibility for unauthorized transactions;
- Where the card can be used, and suggestions for use if certain vendors may seek payment authorization in an amount greater than the consumer's actual purchase;
- The national bank's obligation as issuer to authorize transactions through use of the card, and examples of the circumstances under which it may

refuse to do so;

- The importance of the card recipient tracking the balance remaining on the card; and
- How consumers can resolve problems and complaints and receive balance and other information about their cards.

See id., OCC App. at 2-3.

Thus, through such guidance and its supervision of national banks, the OCC helps assure that consumers receive necessary information to help them understand a national bank's giftcard products, including any fees and expiration date, so that purchasers may make informed decisions whether to buy a national bank issued giftcard, and recipients are able to make informed decisions about the terms governing use of the card.

B. National Banks May Use Agents In Conducting Their Authorized Banking Activities

Federal law specifically grants each national bank the power to exercise "by its board of directors or duly authorized officers or agents" all express and incidental powers necessary to carry on the business of banking. 12 U.S.C. § 24(Seventh). As with the other powers granted in the National Bank Act, national banks' power to use third parties to carry out tasks related to providing banking products and services to their customers is broad and is intended to encompass all normal uses of agents that ordinarily would be encountered in carrying out any business.

The OCC has previously addressed national banks' use of agents in various settings. For example, we have made it clear that national banks may use automobile dealers as agents in making retail automobile loans. Preemption Determination (Michigan Motor Vehicles Sales Act), 66 Fed. Reg. 28,593 (May 23, 2001). This determination was based in part on a regulation providing that "[a] national bank may use the services of, and compensate persons not employed by, the bank for originating loans." 12 C.F.R. § 7.1004(a). Similarly, the OCC has provided by regulation that national banks "may designate bonded agents to sell the bank's money orders at nonbanking outlets." 12 C.F.R. § 7.1014. National banks' power to use third-party agents to carry on a banking business authorized under federal law similarly includes the power to use an agent to promote, market, and perform ministerial duties necessary to deliver the bank's products, here giftcards, to the bank's customers.

II. NEW HAMPSHIRE LAWS THAT WOULD IMPAIR THE ABILITY OF NATIONAL BANKS TO OFFER THEIR FEDERALLY AUTHORIZED GIFTCARDS ARE PREEMPTED.

Under the Constitution's Supremacy Clause, when the federal government acts within the sphere of its authority, federal law is paramount over, and preempts, inconsistent state law. *See, e.g., McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316 (1819). The nature and degree of disharmony between state and federal law that will trigger preemption has been expressed in a variety of formulations,[5] but has been usefully summarized as a question whether, under the circumstances of a particular case, the state law may "stan[d] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Barnett*, 517 U.S. at 31 (*quoting Hines v. Davidowitz, supra*). Those principles have repeatedly been applied to invalidate state authority that would pose obstacles to the exercise of national bank powers.[6]

[5] "This Court, in considering the validity of state laws in the light of treaties or federal laws touching the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

[6] The Supreme Court established long ago that "the states can exercise no control over [national banks], nor in any way affect their operation, except in so far as Congress may see proper to permit." *Farmers' & Mechanics' Nat'l Bank v. Dearing*, 91 U.S. 29, 33-35 (1875). *See also First Nat'l Bank of Logan v. Walker Bank & Trust Co.*, 385 U.S. 252, 256 (1966) (observing that "[t]he paramount power of the Congress over national banks has * * * been settled for almost a

As explained above, U.S. Bank is exercising powers granted to national banks under the National Bank Act in engaging in each aspect of its giftcard program that is challenged by the New Hampshire Attorney General as violating state law. Under the Supremacy Clause of the United States Constitution, that state law, as applied to U.S. Bank's giftcard program, is preempted.

To avoid the result dictated by the Supreme Court's construction of the National Bank Act as granting national banks powers that ordinarily preempt conflicting state laws, the Attorney General argues that she avoids conflict in this instance by targeting U.S. Bank's agent, rather than the bank itself. The crux of the Attorney General's argument appears to be that because the bank, theoretically, has other alternatives to using SPGGC (or any other third-party) as its agent, imposing sanctions on the agent for carrying out tasks on behalf of bank cannot be viewed as causing the type of interference with U.S. Bank's power to sell giftcards that would result in preemption. Yet the Supreme Court has consistently rejected arguments of this nature.

In *Barnett*, the State of Florida permitted unaffiliated state banks in small

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century and a half"). *See generally Barnett Bank* (federal statute preempts state statute restricting bank sales of insurance); *Bank of America v. City and County of San Francisco*, 309 F.3d at 561 (9th Cir. 2002) (National Bank Act of 1864 "was enacted to protect national banks against intrusive regulation by the States.").

towns to sell insurance, but prohibited all other banks from doing so. The State argued that the purpose of the National Bank Act in authorizing national banks to sell insurance was "to grant the bank only a very *limited* permission, that is, permission to sell insurance *to the extent that state law also grants permission to do so.*" *Barnett*, 517 U.S. 31-32. (emphasis in original). The Court rejected this argument on the grounds that national banks' powers "ordinarily pre-empt[] contrary state law." *Id.* at 32; *see also State of Missouri ex rel. Burnes Nat. Bank v. Duncan*, 265 U.S. 17, 24 (1924) ("*Burnes Nat. Bank*") (State law prohibiting its probate courts from allowing any bank to serve as executor of an estate is inapplicable to national banks because federal law authorizes them to serve in that capacity).[7]

[7] The Supreme Court explained the limit on state authority as follows:

> The States cannot use their most characteristic powers to reach unconstitutional results. * * * There is nothing over which a State has more exclusive authority than the jurisdiction of its courts, but it cannot escape its constitutional obligations by the device of denying jurisdiction to courts otherwise competent. * * * So here—the State cannot lay hold of its general control of administration to deprive national banks of their power to compete that Congress is authorized to sustain.

Burnes Nat. Bank, 265 U.S. at 24 (citations omitted).

The Supreme Court has made it clear that a state law is just as offensive, and subject to preemption, when it purports to act upon the officers and agents of a national bank, rather than the bank itself. In *Easton v. Iowa*, 188 U.S. 220 (1903), a state statute made it a crime for a bank to receive deposits when insolvent and a state court convicted the president of a national bank for violation of the state statute. The Iowa Supreme Court upheld the conviction, explaining that Iowa's "statute [was] in the nature of a police regulation, having for its object the protection of the public from the fraudulent acts of bank officers." *Id.* at 229. According to the Iowa Supreme Court, "the mere fact that in violating the law of the state the defendant performed an act pertaining to his duty as an officer of the bank [did] not in any manner interfere with proper discharge of any duty he owes to any power, state or federal." *Id.*

The Supreme Court of the United States rejected the reasoning of the Iowa Supreme Court in seeking to hold the president of the bank responsible for actions that were authorized under federal law, saying: "Such being the nature of these national institutions, it must be obvious that their operations cannot be limited or controlled by state legislation, and the supreme court of Iowa was in error when it held * * * that there is no reason why the officers of such banks should be exempt from the penalties prescribed for fraudulent banking." *Id.* at 230. The National

Bank Act expressly grants national banks the power to act through officers and *agents* in conducting the banking business. Accordingly, federal law requires rejection of New Hampshire's attempt to hold the agent of U.S. Bank liable for assisting the bank to market its giftcard product, which the bank is authorized to offer under federal law.

Ultimately, agents are simply one of the means through which national banks exercise their powers, and the Supreme Court has made it clear that states may not interfere with national banks' use of such usual and customary ways of conducting business. *Franklin National Bank v. New York*, 347 U.S. 373 (1954). In *Franklin*, a New York statute prohibited all but state-chartered savings banks from using "saving" or "savings" in their advertisements. National banks were authorized to provide savings accounts under federal law and the Supreme Court held that the National Bank Act preempted the state prohibition, stating:

> Modern competition for business finds advertising one of the most usual and useful of weapons. We cannot believe that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business. It would require some affirmative indication to justify an interpretation that would permit a national bank to engage in a business but gave no right to let the public know about it.

Id. at 377-378.

In this case, federal law expressly authorizes national banks to conduct the banking business through agents. Like the prohibition on using "savings" in advertisements addressed by the Supreme Court in *Franklin*, the National Bank Act preempts New Hampshire statutes that would prevent U.S. Bank from using SPGGC as an agent to complete tasks necessary to sell U.S. Bank's giftcards.[8]

These cases leave no room for the Attorney General's argument that the conditions and restrictions imposed by New Hampshire law regarding U.S. Bank's use of SPGGC as its agent in the sale of giftcards do not come into conflict with the

[8] This does not mean, however, that state laws that may apply to an agent or third party performing services on behalf of a national bank are necessarily preempted when federal law would preempt the application of the same law to a national bank. The test is whether the application of the state law to the agent's conduct on behalf of the bank has such an adverse effect on the national bank's ability to engage in an authorized banking activity that the state law can be said to obstruct, impair or condition the exercise of a national bank power. *See, generally, Barnett, supra; Franklin, supra.* Thus, while a state law requiring a national bank to obtain a license to engage in federally authorized banking activity would be preempted, *see, e.g.*, 12 C.F.R. §§ 7.4007(b)(2)(vi) and 7.4008(c)(2)(i), a state law establishing licensing or bonding requirements for all persons engaged in an activity that is otherwise regulated by the state normally would be considered part of the legal infrastructure for conducting business and, therefore, would not be preempted when a national bank uses a third-party that is subject to the state law in conducting its authorized activities. In this case, however, the application of the state law to the national bank's use of SPGGC as its agent impermissibly interferes with the bank's exercise of its power to sell giftcards using an agent.

National Bank Act. Nevertheless, the Attorney General cites several district court cases in support of her argument that the preemptive effect of the National Bank Act cannot apply to a national bank's use of an agent in conducting its banking business. None of those cases, however, can properly be relied upon for the proposition that the National Bank Act never preempts state laws that interfere with a national bank's federally authorized powers so long as the state law is enforced solely against the bank's agent.

As the District Court correctly characterized those cases, they "deal primarily with removal jurisdiction and complete preemption[9] and/or fraudulent or deceptive conduct by the agent of the bank—issues not present in this case." *SPGGC, LLC v. Ayotte*, 443 F.Supp.2d 197, 205 (D.N.H. 2006), Ayotte App. at 104. For example, the court in *Colorado ex rel. Salazar v. ACE Cash Express*, 188 F.Supp.2d 1282 (D. Colo. 2002), never reached the issue of whether the National Bank Act preempts state laws that interfere with a national bank's use of its agent to carry out federally authorized activities. Instead, after a "careful review of the Complaint indicate[d] no allegations directed at * * * a national bank," and

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[9] Complete preemption is a doctrine of federal court jurisdiction. It applies "when a federal statute wholly displaces the state-law cause of action." *Beneficial National Bank v. Anderson*, 539 U.S. 1, 8 (2003). When a federal court finds that it lacks jurisdiction because federal law does not displace the state law cause of action, it is not a finding that conflict preemption does not exist. *See id.* at 6.

concluding that nothing about the defendant's relationship to the national bank involved in the pay-day lending program made the defendant itself a national bank, the Court determined that jurisdiction on the basis of complete preemption was not warranted. *Id.* at 1285.

Moreover, the Attorney General is in error when she suggests that conflict preemption cannot occur in the absence of a specific regulation by the OCC. Although federal regulations have the same preemptive effect as federal statutes, *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982) (federal regulations issued under authority of federal law preempt contrary state law), they are not a prerequisite to finding conflict preemption. *See*, *e.g.*, *Barnett*, *supra; Franklin*, *supra;* and *Burnes Nat. Bank*, *supra*.

The Attorney General seriously errs when she states that "the OCC believes that state law controls in this matter," citing two letters from Daniel P. Stipano, who was OCC Acting Chief Counsel at the time. Appellant's Opening Brief at 29. In a letter dated January 5, 2005, Mr. Stipano provided the OCC's views on two issues: (1) the application of the doctrine of "complete preemption" to claims by the Massachusetts Attorney General challenging certain aspects of an earlier giftcard program that involved SPGGC and a different national bank; and (2) the application of certain OCC regulations and the National Bank Act in general to the fees charged in connection with that earlier, different giftcard program.

In the earlier giftcard program that was the subject of Mr. Stipano's letters, the OCC concluded that the doctrine of complete preemption did not apply because federal law did not provide the exclusive cause of action for challenges to the fees at issue. The fees were set by SPGGC, collected by SPGGC, and retained by SPGGC. The OCC also concluded that the giftcard at issue did not involve fees charged by the bank, the only issue considered in the letter.[10] Instead, the bank involved in the earlier program was compensated by SPGGC based on the dollar volume of the giftcards sold. Thus, the OCC stated that we did "not believe the state restrictions on **Simon's** fees would be preempted by [OCC regulations] or the National Bank Act generally." Letter from Daniel P. Stipano, Acting Chief Counsel, Office of the Comptroller of the Currency to Thomas F. Reilly and Margaret M. Pinkham (January 5, 2005) (emphasis in original), Addendum to

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[10] The OCC has distinguished between bank-issued giftcards and arrangements through which a third-party can facilitate the use of its product in a payment card network. Bank issued giftcards are a bank product in which the consumer's agreement is with the bank, and the giftcard and all disclosures identify the bank as the issuer of the giftcard. The bank is the party with financial responsibility to merchants that honor the card, and the bank sets and retains the fees associated with the card. The bank is also subject to the Federal Trade Commission Act's prohibition against unfair and deceptive acts or practices, 15 U.S.C. § 45(a)(1), and to all other requirements applicable to bank products. OCC Bulletin 2006-34, OCC App. at 1-2.

Appellant's Opening Brief 60-61. Consistent with OCC Bulletin 2006-34, under the U.S. Bank giftcard program it is U.S. Bank that sets, collects (either directly or through its agent), and retains all fees that are assessed in connection with the operation of the program as an exercise of its authorized banking powers, and in accordance with 12 C.F.R. § 7.4002. *See* Declaration of John Focht in Support of U.S. Bank's Supplemental Briefing in Support of SPGGC, LLC's Motion for Summary Judgment, Ayotte App. 230-234. The disclosures given to the consumer are prepared by U.S. Bank. *Id.* at 231, 232, ¶¶ 7, 16. U.S. Bank alone is responsible for the value stored on the giftcards it provides. *Id.* at 231, ¶¶ 7, 9. And U.S. Bank is responsible for remitting funds to merchants in connection with use of the giftcard by the consumer. *Id.* at 232, ¶ 11. In these circumstances, as explained above, the New Hampshire statute that prohibits those fees is preempted.[11]

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[11] These factual distinctions also explain, in part, the different result reached by the court in *SPGGC, Inc. v. Blumenthal*, 408 F.Supp.2d 87 (D. Conn. 2006). While the Connecticut District Court correctly concluded that "SPGGC [did] not acquire national bank status" as a result of its relationship to Bank of America, *id.* at 94, that court failed to completely analyze the effect of Connecticut's prohibitions on the national bank. In that case, the court correctly concluded that the state prohibition on the fees charged in connection with the giftcard did not interfere with the exercise of national bank powers because SPGGC set and retained the fees. *See id.* at 94-95. Having reached these conclusions, the Court did not separately analyze the effect of the Connecticut's prohibition on the establishment of an expiration date for the cards on Bank of America's power to

Mr. Stipano's letter of August 12, 2005, has even less bearing on the issues in this case than the January 5th letter. The second letter responded to SPGGC's request for access to non-public OCC information. It sets forth the agency's reasons for denying access to documents prepared as part of the OCC examination of Bank of America, not U.S. Bank. It did not address any of the legal issues raised in this case. And it clearly cannot be cited as evidence that the OCC agrees with the Attorney General's construction of the National Bank Act or of agreement with the Attorney General's arguments regarding state authority to interfere with national banks' ability to use third-parties in carrying out their authorized activities.

CONCLUSION

The district court concluded "that the provisions of the New Hampshire CPA which the State seeks to enforce against Simon with respect to the [U.S. Bank] Giftcard program are preempted by federal banking law." For all the reasons set

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sell giftcards with that feature. However, the court itself acknowledged that if the national bank were "the plaintiff in this case, a different analysis might be required." *Id.* at 95.

forth above, that decision is based on a proper analysis of the federal laws governing the activities of national banks and should be affirmed.

Respectfully submitted,

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January 17, 2007

**CERTIFICATE OF COMPLIANCE WITH
TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS,
AND TYPE STYLE REQUIREMENTS**

This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) and 32(a)(7)(B) because it brief contains 5,960 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii), and this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Office Word 2003 and 14 pt. Times New Roman font.

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Horace G. Sneed

APPENDIX TO
BRIEF *AMICUS CURIAE* OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY IN SUPPORT OF APPELLEE U.S. BANK, N.A.

OCC 2006-34

OCC BULLETIN

Comptroller of the Currency
Administrator of National Banks

Subject:	Gift Card Disclosures	Description	Guidance on Disclosure and Marketing Issues

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

PURPOSE AND SCOPE

This bulletin is intended to provide guidance to national banks on a number of disclosure and marketing issues presented by gift cards, so that national banks that issue gift cards do so in a manner in which both purchasers and recipients of gift cards are fully informed of the terms and conditions of the product.[1]

BACKGROUND

A gift card is a type of prepaid or stored value card that is designed to be purchased by one consumer (purchaser) and presented as a gift to a second consumer (recipient).[2] The terms and conditions of different gift card products can vary significantly, but gift cards are generally divided into two main categories: retail gift cards and bank-issued gift cards. A retail gift card is typically offered by a major retail, entertainment, or food service company, to be used at establishments owned and operated by that company. A bank-issued gift card is typically issued by a financial institution, carries the logo of a payment card network such as VISA, MasterCard, or American Express, and can be used at the various locations that accept cards from that network.[3]

A bank-issued gift card is typically a bank product, and not merely an arrangement through which a third party can facilitate the use of its product in a payment card network. When a gift card is a bank product, the consumer's agreement is with the bank, and the gift card and the related disclosures, the cardholder agreement, and other documentation will specifically identify the bank as the issuer of the card. In addition, the bank generally will establish and impose the fees and other terms associated with the card and control the net proceeds of such fees; will be the party with the financial responsibility to merchants that honor the card; and will hold for its

1 This bulletin is limited to particular disclosure matters relating to bank-issued gift cards. It does not address other supervisory issues relating to these products or to other types of "prepaid" or "stored value" card products.
2 In this regard, gift cards differ from payroll cards, travel expense cards, and other types of prepaid card products that are not designed to be marketed as a gift from one consumer to another.
3 As in the case of credit cards, bank-issued gift cards may be co-branded and offered through, or jointly with, a retailer or other company such as a retail shopping mall, but these cards generally have the same broad acceptability as other bank cards.

own account, or for the account of the consumer, the pool of funds used to pay merchants when consumers present gift cards to pay for goods and services.[4]

Industry studies and media reports suggest that the gift card market is growing rapidly, and will continue to do so over the next several years. This rapid growth – together with the diversity of fees and other terms and conditions among different gift card products – shows that it is important for national banks that offer these products to adopt sound disclosure practices to help ensure that consumers understand the gift card products they are purchasing and using.

CONSUMER DISCLOSURES

Because the purchaser and the recipient of a gift card typically are not the same person, gift cards present unique disclosure challenges. In particular, providing disclosures to a gift card purchaser may not be sufficient to avoid compliance and reputation risks related to misunderstanding by a recipient about material costs, terms, and conditions of the gift card. In these circumstances, the OCC expects national bank gift card issuers to take appropriate actions to ensure that critical information is provided in a form that is likely to be readily available to recipients, as well as purchasers, of gift cards. Accordingly, with respect to gift cards that are bank products, the OCC would expect to see the following disclosures:

- Disclosures on Gift Cards. Basic information that is most essential to a gift card recipient's decisions about when and how to use the card should be provided on the gift card itself, or on a sticker or tape affixed to the gift card. In light of the terms and provisions of most bank gift cards, this information generally will include disclosures relating to the following matters:

  - The expiration date of the card (which, consistent with existing practices for credit and debit cards, should be presented clearly on the front of the card);

  - The amount or the existence of any monthly maintenance, dormancy, usage, or similar fees; and

  - How consumers may obtain additional information about their cards or other customer service (for example, by providing a toll-free number or Web site address).

- Disclosures Accompanying Gift Cards. Other information that is important to a gift card recipient's decisions and actions should be provided in a form that is designed to be passed on with the card to the recipient, and issuers should encourage card purchasers to provide this information to gift card recipients. For example, the card could be carried in promotional packaging that contains this material information, or inserted into a sleeve that sets forth or is attached to these disclosures. Depending on the terms of the gift card product, this information may include:

  - The name of the bank that issued the card;

4 In connection with the gift card, the bank would be subject to the prohibition against unfair or deceptive acts or practices in the Federal Trade Commission Act, 15 USC 45(a)(1), and to all other requirements applicable to bank products.

- Any other fees that may apply to the card, including card replacement or reissuance fees, balance inquiry fees, foreign currency conversion fees, and cash redemption fees, and how they will be collected (for example, by debits to the card balance);

- Whether and how consumers can receive a replacement card in the event that their card is lost or stolen, the information that consumers need to retain in order to do so, and responsibility for unauthorized transactions;

- Where the card can be used, including, if applicable, suggestions for using the card at gas stations, hotels, restaurants, or other locations that may seek payment authorization in an amount greater than the consumer's actual purchase;

- The issuer's obligation to authorize transactions through use of the card, and examples of the circumstances under which it may refuse to do so;

- The importance of tracking the balance remaining on the card;[5]

- Whether, and if so, how the card may be used in "split payment" transactions (when the card is used in conjunction with another form of payment) and the process for redeeming *de minimis* remaining balances;

- How consumers can resolve problems and complaints and receive balance and other information about their cards; and

- When applicable, the issuer's ability to revoke or change the terms of the gift card agreement.

PRACTICES TO AVOID

National bank gift card issuers should take appropriate steps to avoid engaging in marketing or promotional practices that could mislead a reasonable consumer about the terms, conditions, or limitations of the bank gift card product they are offering. For example, issuers should not advertise a gift card as having "no expiration date" if monthly service or maintenance fees, dormancy fees, or similar charges can consume the card balance and thereby have the same practical effect as an expiration date. Similarly, if such fees may consume the card balance before the stated expiration date for the card arrives, disclosures relating to that expiration date (other than the disclosure on the front of the card) should explain that possibility. Issuers also should generally avoid describing gift card products in terms suggesting that they are similar to gift certificates or other payment instruments with which consumers may be more familiar, or as products that carry federal deposit insurance when such insurance does not apply.

5 Some gift card issuers provide a simple chart, similar to a checking account register, for gift card recipients to use to track their purchases and remaining balances.

Questions concerning this bulletin may be directed to the Community and Consumer Law Division at (202) 874-5750 or to the appropriate supervisory office.

/s/

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

OCC 96-48
Subject: Stored Value Card Systems Description: Information for Bankers and Examiners

To: Chief Executive Officers of all National Banks, Department and Division Heads, and all Examining Personnel

Purpose

The purpose of this bulletin is to provide basic information about emerging stored value card systems, and to outline their associated risks so that bankers can make informed decisions about whether and how to become involved in such systems. The bulletin is not intended to establish policy requirements on how banks must manage these risks. Rather, it provides basic information to assist banks in fulfilling their responsibility to identify and manage risks as they become involved in stored value systems.

To that end, this document presents a definition of stored value cards and describes stored value card systems that are emerging. It also outlines the various functions and roles that banks can play in stored value card systems. Like credit and debit cards, stored value cards are likely to become major products for some banks. However, as with any financial product, stored value cards present risks to participants. This bulletin describes the risks banks may face in investing or participating in stored value card systems based upon the risk categories of OCC's Supervision by Risk program. Finally, the document raises basic consumer awareness issues.

Background and Definitions

Electronic cash can be stored in several forms: directly on a central computer, on individual personal computers (PCs), or on a stored value card. Although some potential risks associated with electronic cash are the same no matter how it is stored and delivered, certain risk exposures vary depending on the delivery channel selected. This bulletin will focus on the stored value card delivery channel.

The term stored value card typically refers to a card either with a magnetic stripe or with a computer chip that is charged with a fixed amount of economic claims or value that can be "spent" or transferred to individuals and/or merchants in a manner that is similar to spending paper money or coins. Depending on the particular system adopted by the vendor, stored value cards can operate more like debit cards or more like the functional equivalent of electronic cash.

Electronic cash refers to stored value represented by a digital computer code that consumers use for payments processed through a computerized financial network. A consumer executes these payments using a stored value card in conjunction with a personal computer, an automatic teller machine (ATM), a television cable connection, an enhanced telephone, or some other form of telecommunications equipment. When the consumer spends electronic cash with a merchant, the point of sale (POS) device "collects" the appropriate amount for the merchant, deducting electronic cash from the stored value card. The merchant then can redeem the accumulated electronic cash from the POS device for currency or a credit to a deposit account.

Although debit transactions also can be processed electronically, electronic debit transactions should not be confused with true electronic cash transactions. The distinction between stored value and debit transactions is significant because, although similar in some respects, they can present different regulatory and supervisory issues.

A debit card is used to access an account, in order to withdraw or transfer funds from or to existing accounts. Consumers accomplish these withdrawals or transfers either through ATMs or POS devices. Although these cards have magnetic stripes that contain account information, there is no value stored directly on the card as is the case with stored value cards. The distinction between debit and stored value cards, as noted above, can be fuzzy depending on the system adopted by the vendor; moreover, it should be noted that some systems will offer multi-function cards that can enable a consumer to perform payments by electronic cash, by debit or by drawing on a credit line.

A smart card is a plastic card with an embedded computer chip that looks like a credit card. Smart cards may be used as stored value cards. Depending on the capacity of the integrated circuit, the smart card may hold limited information, or may have the ability to perform more complex computing functions. For stored value smart cards, an electronic device is used to read the existing value of electronic cash and to load (add) or deduct electronic cash stored on computer chip. Smart cards, functioning as stored value cards, can operate within existing and future technologies for example, retro-fitted ATMs, augmented telephones such as screen phones and smart phones, electronic purses (stand alone dedicated devices), or PCs.

Stored value cards may be disposable or reloadable. Disposable cards store a one-time fixed amount of electronic cash. Reloadable cards generally store electronic cash on a computer chip and interface with special loading devices that allow a consumer to load electronic cash on the card. Each system could have specific features such as limits on the amount of electronic cash that can be stored or cards that expire after some established time period.

Finally, stored value card systems may be loosely characterized as either "closed" or "open" systems. In a pure closed system, the stored value card is accepted only by a single merchant or entity. Among other functions, closed stored value card systems are used to pay for public transportation and telephone calls. The issuer distributes the cards to customers of a single merchant and redeems all payments. In contrast, an open system may have one or more electronic cash issuers of stored value cards that are accepted by multiple merchants. These systems require a valid payment systems network for collecting and processing the electronic cash payments received by merchants.

In one respect, most stored value card systems, whether open or closed, function like bank debit or credit card systems; the electronic cash can only be "spent" with a merchant and must be presented to the issuer for redemption. However, some more complex stored value card systems permit transfer of electronic cash from one storage device to another without restrictions. These are called purse-to-purse systems because the electronic cash can move from one consumer electronic purse to another. In such systems, the electronic cash is allowed to circulate for an indefinite period before it is presented back to the issuer for redemption.

Risks in Stored Value Card Systems

This section identifies the risks that arise in connection with specific functions and roles that banks can perform in stored value card systems. These risk categories are based upon the OCC's Supervision by Risk program and are more fully described in the appendix section attached to this document.

National banks may perform or have performed for them one or more of the functions in stored value card systems, each with a specific structure and level of risk. A bank can be involved in stored value systems as an investor or as a non-investor participant. A bank also can perform the function of electronic cash issuer, i.e., the institution that creates electronic cash. The same bank can also act as distributor and redeemer of electronic cash, selling stored value cards to consumers and contracting with merchants to convert their electronic cash into currency or a deposit account balance. In most stored value card systems, transactions will be processed at the point of sale by an electronic device without further authorization. In the few stored value systems designed to require individual transaction authorization, however, a bank may perform the function of transaction authorizer. If electronic cash issued by one bank (one entity) is accepted by a merchant that contracts with another bank, or series of banks, then banks can function as a clearinghouse to settle such transactions. Finally, in electronic cash systems, some bank or entity will probably maintain a transaction archive for error resolution, fraud, or counterfeit detection.

A bank should be clear as to who bears the responsibility at each stage of an electronic cash transaction. Thus far, transactional rules for some electronic cash systems are not well established by current law. Accordingly, in many important respects, the transactional rules for such systems must be established by contract. For example, contracts might specify which party is liable for: malfunctioning cards, lost cards, operational errors, and counterfeit electronic cash or stored value cards. Where this occurs, the bank should be sure that it has a valid and clear contract with the relevant parties. For this reason, banks should consider the risks that arise as a result of relying on contracts entered into solely through electronic communications.

Risks in Specific Functions and Roles

Investing banks: An investing bank is a bank that has an equity stake in a stored value system. As such, the bank incurs a strategic risk that the venture will not perform well or fail and thus cause the bank to lose its investment. The scope of any additional potential liability, however, depends on contractual obligations undertaken by the bank, the type of entity in which the bank invests, and how the entity conducts the stored value operations. Generally, the ownership structure, if properly designed and implemented, can shield the investing bank from liability under the laws that limit liability for owners of corporations and limited liability companies.

Issuing banks: An issuing bank is the obligor for its electronic cash. The issuing bank sells electronic cash directly to consumers, or contracts the selling function to another firm. When the issuer sells its electronic cash directly to consumers, it is essentially selling bank liabilities to its customers. The issuer takes the proceeds from the sale of electronic cash and invests or holds the proceeds until the electronic cash is presented to the issuer for redemption. The issuer of electronic cash is exposed to a number of risks related to its development and operation of the stored value card system (i.e., strategic, transaction, compliance, and reputation risk) as well as risks associated with its ownership of electronic cash and investing proceeds from the sale of electronic cash (i.e., credit, liquidity, interest rate, and foreign exchange risk). The investment policy of the issuer should dictate the extent of credit, liquidity, and interest rate risk exposure of the bank. If the portfolio includes any foreign securities, exposure to foreign exchange risk exists. Please refer to the appendix section of this document for a more detailed description of these risk categories.

Distributing banks: Any bank that distributes or sells electronic cash on stored value cards, whether it is an issuer, is exposed to transaction, compliance, reputation, credit, and liquidity risk. The transaction risk of a distributor can result from errors in the distribution process. Transaction risk may be increased because existing commercial law standards were not developed with stored value technology in mind, and some of the basic commercial law rules for stored value transactions have yet to be established. Thus, well conceived contracts setting out the rights and obligations of the parties are important considerations for effective risk management of this area.

Compliance risk is present because as a distributor the bank may be the primary contact for consumers and, thus, is responsible for distributing necessary disclosures and (in some systems) for initiating an error resolution process. See the Consumer Awareness section of this bulletin for additional discussion of the compliance risks for distributing stored value cards. Reputation risk involves the bank's exposure to litigation, financial loss, or damage to its reputation resulting from customer dissatisfaction or adverse public reaction to any aspect of the stored value card product. The potential for credit risk exposure arises from accepting payment for electronic cash from consumers in a form other than cash or a deposit of the distributing bank. Liquidity risk exposures may result from any delays in converting payments to currency or a deposit account balance.

- o Distributing banks as selling agent: In some systems, non-issuing banks have a role that is similar to their role in distributing travelers checks. They do not take title to the electronic cash, but instead act as agent on behalf of the issuing entity, selling the issuer's electronic cash to customers. In this role, the risk exposure to the bank is limited since the bank does not have ownership of the electronic cash. The primary risks to the bank are transaction and compliance risk.

In some systems, the banks, as agents, will control the process for loading the electronic cash (digital computer code) onto the stored value card on behalf of the issuer. Since this process creates an obligation of the issuer, the bank will be responsible for ensuring that appropriate controls are in place for safeguarding the computer hardware and software used in this process.

Distributing agent banks also can incur a risk of being obligated to the electronic cash purchaser if they fail to disclose fully to purchasers their true and limited function regarding the electronic cash. This can occur if a distributing agent bank places its name on a stored value card and fails to make it clear to a purchaser of electronic cash that the bank is not obligated on the electronic cash. For example, if the distributing agent bank fails to inform the purchaser (i.e., consumer) that it is acting as the agent of the issuer, a consumer might seek to hold the agent bank obligated on the electronic cash under a legal theory which imputes the liability of a principal to an agent that has caused others to reasonably believe that the supposed agent was acting as a principal. Appropriate disclosures will help to control these risks.

o Distributing banks as underwriters: In other systems, non-issuing banks purchase the electronic cash from an issuer and then re-sell the electronic cash to their customers. These bank underwriters take title to the electronic cash and hold it until resale or until redemption with the issuer. Since the bank takes ownership of the electronic cash, it incurs (in addition to the risks identified for the distributing agent bank) a credit risk vis-a-vis the issuer, i.e., the risk that the issuer will default on its obligation to redeem the electronic cash.

Transaction authorizing banks: In some stored value card systems, merchants will require authorization before accepting electronic cash to ensure that it is valid. This is similar to credit card systems where a merchant communicates, through the bank card network, with the issuing bank before accepting a credit card payment.

Banks that authorize the exchange of electronic cash for goods and services are exposed to transaction risk. Controls need to be in place to ensure the accuracy of the banks' information. Banks that do not have adequate controls over data integrity run the risk that they will incur liability for the improper authorization of transactions. An authorizing bank should also ensure adequate system capacity and recoverability, so that transactions are consistently authorized on a timely basis.

Redeeming banks: In all open stored value systems, holders of electronic cash will be able to convert electronic cash to currency or funds added to a bank deposit account. Banks act as redeemer when they receive electronic cash from merchants for redemption. Redeeming banks incur risks associated with their roles as collection agents or as principal.

o Redeeming banks as collection agents: In some systems, banks have a redemption role similar to their role in the check collection process. In that capacity, banks are not required to purchase or redeem the electronic cash for merchants, but instead act as their collecting agent by presenting the electronic cash to the issuer for payment and then crediting the merchants' accounts with the funds received. The bank does not take title to the electronic cash as part of the collection process and therefore avoids the risks associated with owning the electronic cash. Nevertheless, banks acting as collecting agent will have an obligation to merchants to make proper and effective presentment; this obligation subjects them to transaction risk. Moreover, if the bank grants the merchant provisional credit on the redeemed electronic cash pending settlement, the bank incurs a credit risk to the merchant that may be realized if the issuer defaults and the bank is unable to charge back the merchant's account.

o Redeeming banks as principal: In other systems, participating banks are obligated to act as principal and redeem electronic cash by purchasing the electronic cash from merchants, thereby taking title and exposing them to all of the risks associated with ownership. Upon purchase, the bank may either hold the electronic cash for resale to merchants or redeem it with the issuer.

Clearing and settling banks: Clearing and settling a payment transaction requires transmitting both information and funds through a valid payment systems network. Banks involved in clearing and settlement may be continuing a role they undertook as redeemer for their customers or, alternatively, they may accept that role on behalf of other banks and act as an intermediary in the process through which the electronic cash is presented to the issuer for payment. Clearing and settling banks may be exposed to transaction, credit, liquidity, and foreign exchange risk. The applicability of these risk categories is similar to those same risks as described under Issuing and Distributing banks. Also, please refer to the appendix section of this document for a more detailed description of these risk categories.

In electronic cash systems with a single issuer, minimal processing is needed for settlement because the collecting banks need only present all the electronic cash to the single issuer. After the electronic cash is presented to the issuer, the issuer redeems the electronic cash, sending the proceeds or funds to the clearing banks. The subsequent action by the clearing bank will depend on whether it has redeemed the electronic cash as principal or as agent. If acting as principal, the bank will retain the proceeds or permit the issuer to retain the proceeds to offset obligations that the bank owes to the issuer. If the bank has acted as agent, it will forward the proceeds to the appropriate consumers and merchants.

In multiple issuer systems, redeeming banks will usually need to use some clearinghouse mechanism to have the electronic cash presented to the appropriate issuer for payment. In such systems, electronic cash transactions likely would clear through the existing bank clearinghouse network. Bank members to the clearinghouse likely would incur the same types of risks of member failure that they incur in other clearing house arrangements. (Refer to OCC Banking Circular 271 (May 1993) for a detailed discussion of risks associated with clearinghouses.)

Banks that participate in the clearing and settlement process potentially also are exposed to risks that vary depending upon whether they act as principal or agent. Banks that act as principal and therefore take title to electronic cash as part of the clearing process are exposed to the additional risks (i.e., transaction and credit risk) associated with ownership of the electronic cash. Agent banks that do not take title to the electronic cash are exposed to transaction risk. They may incur liability to their customers if they fail to process items for clearing and settlement on a timely basis. The banks' credit risk is limited to the risk that the clearinghouse will fail.

Transaction archiving banks: There are two types of record keeping or archiving systems. In the first, a central system archives records of each transaction on a given stored value card separately, as it is executed. These systems are fully auditable. The second system records each transaction, but in batch form, merchant-by-merchant (electronic cash recipients). Although it would be possible to establish an audit trail for an individual stored value card under the second type of system, it would result in greater costs. Both kinds of record keeping systems can be used to settle disputes between consumers, merchants, and participating banks. They also could be used by the government to investigate suspected crimes.

The transaction archiving role can expose the bank to transaction, reputation, and compliance risk. Transaction risk results from problems with data integrity that can lead to losses from the inability to resolve errors accurately, to identify patterns of fraud, or to recognize counterfeit electronic cash. Reputation risk may arise from public criticism of a bank's improper or incompetent handling of customer information or complaints. Compliance risk may arise if records do not conform to applicable federal or state consumer regulations, particularly those imposing obligations to safeguard confidential information.

Consumer Awareness

Stored value cards are new products that may outwardly resemble some existing debit and credit card products. However, stored value cards function differently from debit and credit card products and can expose customers to different risks. For this reason, it important for banks to take appropriate steps to adequately inform consumers of their rights and responsibilities when using stored value cards. To do so, banks will need to keep informed of regulatory developments in this area.

In 1994, the Federal Reserve Board (FRB) issued a proposal to simplify and update Regulation E. In that proposal, the FRB indicated that smart cards (defined as plastic cards that have the capacity to either compute or communicate information) would be subject to Regulation E if the cards are used to access a customer account. As a result of several issues raised during and after the public comment period, the FRB is now proposing another amendment to Regulation E. [See 61 Federal Register 19696 (May 2, 1996).]

Additionally, the Federal Deposit Insurance Corporation (FDIC) recently issued a legal opinion on the extent to which funds underlying stored value cards may be considered to be deposits covered by federal deposit insurance. [See FDIC General Counsel's Opinion No. 8, 61 Federal Register 40490 (August 2, 1996).] The opinion holds that stored value (electronic cash) issued by banks will be insured if the funds underlying the electronic cash remain in a customer's account until it is transferred to a merchant or other third party, who in turn collects the funds from the customer's bank. However, bank-issued electronic cash does not result in an insured deposit when the underlying funds are placed in a reserve or general liability account held by the issuing bank to pay merchants and other payees as they make claims for payments. Electronic cash issued by nonbanks will not be insured even if distributed or sold by banks.

The OCC encourages banks to consider the basic disclosures needed for stored value cards they distribute. Among others, banks should consider the following topics when deciding how to adequately inform consumers:

- How to use the card.
- Where and how the consumer can increase the value on the card.
- Whether the electronic cash earns interest, dividends, or any other return.
- Where, how, and when the electronic cash can be redeemed.
- All fees charged in connection with obtaining or using the card or the electronic cash stored on it.
- The name of the entity that issues the electronic cash and its obligation to redeem it.
- Whether the consumer is protected in case of a lost or stolen card.
- Whether the amount of the electronic cash transferred to the card is insured by the FDIC.
- Where does liability lie if a transaction is not properly consummated.
- What happens to electronic cash that is abandoned or expires under the terms of the agreement.
- How consumers can resolve disputes involving electronic cash transactions.
- The circumstances under which information on a consumer's electronic cash transactions may be disclosed to third parties.

If a bank sells electronic cash stored on media other than a stored value card (i.e., a computer hard disk), it should consider similar disclosures appropriate to those electronic cash devices.

Questions regarding this bulletin should be directed to the Chief National Bank Examiner's Office at (202) 874-5190.

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Jimmy F. Barton

Chief National Bank Examiner
September 10, 1996

Appendix

Appendix

Description of General Risks in Stored Value Card Systems

Banks involved in stored value systems are exposed to a variety of risks. While the exact nature of that risk exposure depends on the design of the specific system and upon the precise role or roles the bank assumes, the general types of risks common to such systems are described here. These are the same risk categories that are provided in the OCC's Supervision by Risk program. Descriptions of credit and interest rate risk are taken verbatim from the Comptroller's Handbook section on Bank Supervision Process. The other applicable risk descriptions have been altered to focus on the environment for stored value card systems. In all cases, each risk is presented based on its impact to capital and earnings. The primary risks for banks participating in stored value systems are transaction, strategic, reputation, and compliance.

Transaction risk: Transaction risk is a function of the adequacy of internal controls, data integrity, transaction rules, employee performance, and operating processes in stored value card systems. Maintaining data integrity is extremely important as it determines the fundamental reliability of data or information. Information systems should provide timely, accurate, and secure data in order to prevent errors and maintain customer satisfaction. Without adequate staff and good internal controls over electronic cash system operations, a bank can leave itself open to potential fraud and costly disruptions in operations. Internal control systems should provide proper access, authorization, and accountability for processing transactions. Effective controls, audit coverage, and other preventive measures should be in place to deter or minimize the impact of fraud, counterfeiting, and other improper activities. Proper contingency planning with appropriate back-up facilities should be considered to ensure timely restoration of operations and continuity of business activity. Transaction risk also can arise from disputes or uncertainty over the transactional rules that apply to payment systems.

Strategic risk: Strategic risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed against those goals, and the quality of implementation. The design, development, and implementation of a stored value card system is a complicated process. Proper product design and pricing are critical to success. If banks do not properly anticipate consumer and merchant behavior for small value transactions, for example, this product may not be widely accepted. Losses also may accrue if the company fails to develop and implement cost-effective point of sale devices and software systems to load and unload the value from the cards. Banks that do not have the expertise to design and service the necessary hardware and therefore decide to contract out for such services may be exposed to risks from poorly conceived contracts for outsourced services, partnership agreements, and other alliances.

Failure to integrate the stored value card system into other bank operations could cause an otherwise successful business plan to fail. The technical hardware and software design should successfully support the stored value card system and be compatible with existing or planned bank systems. Lack of standardization in electronic cash processing, data communication, and transaction security could prevent banks from achieving the volume of business necessary to make stored value card systems viable.

Reputation risk: Reputation risk arises from negative public opinion. For any new product, the reputation of the bank that markets the product is at risk. For example, if a bank provides a stored value card product and subsequently the issuer of the stored value becomes insolvent and defaults, the bank may experience substantial damage to its reputation. Any malfunctions or security breaches that occur also may contribute to reputation risk. There also are risks resulting from potentially of adverse media coverage associated with a brand name. Customer dissatisfaction with the product due to misinformation, lack of information, or failure to resolve problems related to use of the product could result in litigation or adverse publicity that would damage a bank's reputation and subject it to liability.

Compliance risk: Compliance risk arises from violation of, or non-conformance with laws, rules, regulations, prescribed practices, or ethical standards. Stored value systems need to be sufficiently flexible to adapt to a changing regulatory environment because many issues that could cause compliance risk have yet to be resolved. For example, the applicability of consumer protection laws and regulations to stored value card transactions is under review. The Federal Reserve Board (FRB) is in the process of amending Regulation E and has yet to decide how other federal consumer regulations will apply to stored value card systems. Also, the application of the Bank Secrecy Act to such systems is not clear. Finally, states may assert authority over stored value card systems. Thus, for example, banks involved in stored value systems should consider the applicability of state escheat and money transmitter laws.

Even without specific regulatory guidance, issuing banks will need to give consumers basic information about how to use the stored value card. Also, banks will need to be prepared to address consumer questions about electronic cash such as whether electronic cash on stored value cards is federally insured (like deposits) and whether the consumer is exposed to loss if the issuer becomes insolvent or if the card is lost or stolen. (See the Consumer Awareness section of this document for more information.)

Credit risk: Credit risk arises from an obligor's failure to meet the terms of any contract with the bank or otherwise fail to perform as agreed. Credit risk is found in all activities where success depends on counter-party, issuer, or borrower performance. It arises any time bank funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet.

Credit risk is the most recognizable risk associated with banking. This definition, however, encompasses more than the traditional definition for lending activities. Credit risk also arises in conjunction with a broad range of bank activities, including selecting investment portfolio product, derivatives trading partners, or foreign exchange counter-parties. Credit risk also arises due to country or sovereign exposure, as well as indirectly through guarantor performance.

In electronic cash systems, a bank that purchases electronic cash from an issuer and then resells it to its customers incurs risk i.e., the risk that the issuer may default on its obligations to redeem the electronic cash.

Liquidity risk: This risk originates from an inability to meet obligations as they come due without incurring unacceptable losses. Banks that issue electronic cash will be responsible for holding and investing the funds used to purchase electronic cash. Such banks should take into account liquidity risk since some investments may not be easily converted to meet redemption demands without incurring unacceptable losses.

Interest rate risk: Interest rate risk arises from movements in interest rates. The economic perspective focuses on the value of the bank in today's interest rate environment and the sensitivity of that value to changes in interest rates. Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (repricing risk); from changing rate relationships among different yield curves affecting bank activities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest-related options embedded in bank products (options risk). The evaluation of interest rate risk must consider the impact of complex, illiquid hedging strategies or products, and the potential impact on fee income which is sensitive to changes in interest rates. In those situations where trading is separately managed, this refers to structural positions and not trading portfolios.

The assessment of interest rate risk should consider risk from both an accounting perspective (i.e., the effect on the bank's accrual earnings) and the economic perspective (i.e., the effect on the market value of the bank's portfolio equity).

Issuers of electronic cash may face interest rate risk on the portfolio of investments they hold to provide a pool of funds to redeem their circulating electronic cash.

Foreign exchange risk: This risk is found in cross-border investing and operating activities. Foreign exchange risk arises from accrual accounts denominated in foreign currency, including loans, deposits, and equity investments. Banks may choose to accept foreign currencies in payment for electronic cash or structure stored value card systems that accept multiple currencies. In both instances, the bank may be exposed to the risk associated with fluctuations of foreign exchange rates. It should therefore ensure that it possesses the necessary expertise, such as the ability to conduct ongoing revaluations of currency, before it accepts foreign currency transactions.