Gift Cards: The New Plastic in Your Wallet and How the Government Regulates Them

By Jeffrey D. Knowles and Melissa Landau Steinman, Venable

Prepaid debit cards and stored value cards have become increasingly popular alternatives to traditional credit and charge cards in today's plastic-hungry society, where few consumers carry cash. Yet even as marketers seek to explore the seemingly limitless flexibility of this delivery system as a means of promoting their brands, they must be aware of the complex overlay of laws that regulate the use of gift cards ("GCs"). There are three primary types of laws on the books regulating GCs: consumer protection laws; abandoned property laws; and banking laws.

I. Consumer Protection/Unfair and Deceptive Trade Practices Statutes

Many states have regulations that mandate that certain disclosures be printed on the certificate or card. Some states even go so far as to detail requirements for placement and size, although so long as the disclosures are clear and conspicuous that will generally satisfy state regulators. Moreover, in August of 2006, the Office of the Comptroller of the Currency (OCC) issued a Bulletin providing guidance on what it expects to see from national banks in terms of consumer disclosures on GCs.

Expiration dates. Much recent state legislation relating to GCs has focused on the permissibility of imposing expiration dates on GCs. Some states (e.g., California, Maine) prohibit expiration dates altogether. The majority of states permit the imposition of an expiration date but require that any expiration date must be disclosed clearly, and/or require that a gift card must be valid for a minimum number of years, e.g., two, five or seven years after date of issuance. The OCC Bulletin states that expiration dates must be disclosed on the card.

Dormancy and service fees. The question of whether a gift card issuer may reduce its value by charging inactivity or "dormancy" fees, service fees, or similar charges is being hotly debated today, and variation in state law reflects this debate. Some states prohibit dormancy fees altogether; some allow them under specific circumstances. Still others do not limit the fees that can be charged, but impose disclosure requirements. Some states allow fees but require that they be disclosed clearly. The OCC Bulletin states simply that the amount or existence of any monthly fees must be disclosed in the materials that accompany the card.

Other recommended disclosures; restrictions on how a gift card may be redeemed. A number of states seek to regulate how, i.e., in what form, a gift card may be redeemed. For example, in California, GCs must be redeemable in cash for their cash value, or subject to replacement with a new gift card at no cost to the purchaser or holder. In Massachusetts, when a gift card is redeemed for at least 90% of its face value, a consumer must be able to choose to receive the balance in cash or continue.

II. Escheat and Abandoned Property Laws

Also relevant to GCs are state escheat or abandoned property laws, which provide that property may be presumed abandoned under state law if there is no activity with respect to the property for a specified time period. The defined "abandonment period" varies, and property that remains unclaimed for the specified period generally must be turned over to the state. The difficult question is whether, and when, unused GCs are considered abandoned property that escheats to the state.

The states take a variety of different approaches towards addressing GCs and escheat. The majority of states deem GCs that have been unused for a certain period of time (typically three years) to be abandoned property. Some states have taken the opposite approach and excluded GCs from the escheat laws, or have simply deleted all references to "gift certificates" from escheat provisions. Other states have created exemptions for specific types of gift certificates, such as those used in retail sales. New Hampshire law contains a de minimis exemption for GCs with a value of $100 or less.

The consumer protection/escheat conflict. The intersection of consumer protection laws and escheat laws may create a predicament for issuers of GCs. In some states, the holder must honor the gift card for long periods of time (or indefinitely, if expiration dates are prohibited), but the value of the card will escheat to the state after the statutory abandonment period. An issuer could conceivably have to pay the value of the gift card twice: first to the state and then to the consumer due to the state ban on expiration dates.

What's the solution? The general consensus appears to be that the best way to avoid escheat (although not necessarily a foolproof strategy) is not to impose an expiration date on a gift card; to do otherwise (e.g., adopt different expiration periods in different states, or a single expiration period) risks both civil penalty liability under state consumer protection laws and the potential for escheat of unredeemed GCs.

III. The Banking Laws

Merchants issuing GCs may be surprised to learn that because many of the "cards" may be used as debit cards, or even as ATM cards, bank regulators are interested in how they are being used. Moreover, because some cards are reloadable, the federal government is concerned that the cards may be used for money-laundering purposes, in pursuit of terrorist activities.

The issue of how the banking laws apply to GCs is in flux. The FDIC is looking at the issue of whether funds at banks underlying stored value card accounts must be insured, and enforcement authorities disagree whether GC issuers are "money transmitters" that must be licensed. While it is clear that national banks must take certain steps to comply with the law, "marketing partners" of those banks must also carefully evaluate their compliance programs. All parties involved in the marketing of GCs should be aware of the following laws:

8/06 OCC Bulletin. The most recent advice on the application of the banking laws in the gift card context comes from the August 2006 OCC Bulletin, which was intended to provide guidance to national banks on disclosure and marketing issues relating to GCs. Even non-bank GC issuers can look to the Bulletin for guidance in drafting their disclosures.

FDIC Regulations. In 2004, the FDIC began a new rulemaking intended to provide guidance to the industry and the public "as to when funds underlying stored value cards will satisfy the definition of 'deposit' [requiring insurance] at section (3)l of the Federal Deposit Insurance Act (FDI Act)."

Bank Secrecy Act. GC issuers may have to comply with Bank Secrecy Act requirements that mandate that they have policies and procedures in place to comply with the duty to file (1) reports of currency transactions in excess of $10,000 per day; (2) reports of international transportation of foreign currency or monetary instruments; and (3) reports of foreign bank and financial accounts. GC issuers may also have to comply with suspicious activity reporting requirements under the law.

***USA PATRIOT Act*.** The PATRIOT Act requires all "financial institutions" to establish and maintain a customer identification program to ensure that the person whom the financial institution is accepting as a customer is who they say they are. Central to the program is the duty to collect, verify and maintain information that was relied upon to establish identity, including name, address, date of birth and taxpayer i.d. number. To the extent that GC issuers may be "financial institutions," then they may have duties to establish and maintain customer identification under the Act.

State Money Transmitter Laws. Most states have money transmitter laws, which govern entities that issue checks, travelers checks, money orders and electronic equivalents. A small number (Virginia, Maryland, Illinois, Massachusetts, Minnesota, and California) have taken the position that GC issuers are money transmitters. The federal government and other states have not yet determined whether gift card issuers are money transmitters. The laws usually require licensure and payment of fees, may require a surety bond or minimum capitalization, and impose reporting obligations and require periodic audits.

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Marketers seeking to use GCs in their various forms must master the complex web of financial rules, consumer protection laws and abandoned property statutes that regulate the use of such cards. Nonetheless, with a carefully thought out compliance program, savvy companies can capitalize on the extraordinary flexibility of this type of incentive and win consumer loyalty.