MasterCard Worldwide

Response to the Commonwealth Consumer Affairs Advisory Council Community Consultation on Gift Cards

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The Manager
Consumer Policy Framework Unit
Infrastructure, Competition and Consumer Division
Treasury
Langton Crescent
PARKES ACT 2600

CCAAC Gift Card Review
C/- The Manager
Consumer Policy Framework Unit
Infrastructure, Competition and Consumer Division
Treasury
Langton Crescent
PARKES ACT 2600
Via email: ccaac@treasury.gov.au

MasterCard welcomes the opportunity to respond to the issues paper on gift cards entitled “Gift Cards in the Australian Market: Issues Paper” circulated by the Commonwealth Consumer Affairs Advisory Council (CCAAC).

We believe that this is a valuable opportunity to inform the development of consumer protection policy in an area of commerce that is undergoing significant change.

MasterCard Worldwide is a global payments and technology company. It operates the world’s fastest payments processing network, connecting consumers, financial institutions, merchants, governments and businesses in more than 210 countries and territories. MasterCard’s products and solutions make everyday commerce activities – such as shopping, travelling, running a business and managing finances – easier, more secure and more efficient for everyone.

We offer our views from the perspective of an informed and integral participant in the retail and financial industries in Australia and overseas. MasterCard has a strong and vested interest in maintaining consumer and regulatory confidence in card and other electronic-based payments products and the environment in which they operate. We offer a wide range of payment solutions that enable our customers and partners to develop and implement credit, debit and, of particular relevance to this submission, prepaid programs and solutions to deliver value to consumers. MasterCard provides and customises programs to meet unique commercial and consumer needs in all prepaid segments and across the globe, including programs such as general purpose reloadable, gift, employee benefit, payroll, travel, incentive and government disbursement programs.

We welcome this opportunity to provide our perspectives on the Australian market and believe that it is necessary to maintain an open public policy dialogue on aspects of the payments landscape so that consumers have an ample understanding of the products they use, their rights and the regulations that govern them. We would, of course, be happy, to answer any further questions you may have.

Sincerely

Eddie Grobler

Eddie Grobler
Divisional President, Australasia

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1. Introduction

As commerce and technology have evolved over the last 50 years, gift cards have developed into a convenient, flexible and easy to use payment device.

At their simplest, gift cards enable consumers to give another person something having a set value (usually monetary) and then allow the recipient to choose what they wish to spend that value on.

Although frequently characterised as a form of 'store credit', it is arguably more fitting to describe gift cards as a form of prepaid instrument, the value of which can be redeemed at nominated locations.

Recent high-profile retail insolvencies in Australia have prompted discussion of a number of issues and questions concerning gift cards (and vouchers), including how terms and conditions should apply, how generic consumer protection principles should govern them and the respective rights and responsibilities of consumers, issuers and retailers.

While these issues are of legitimate concern, MasterCard believes that it is essential from the outset to use a definition of "gift cards" that is consistent with the definitions used in other countries for such products to take into account the increasingly global nature of commerce. It is similarly important that any new legislative or regulatory provisions that may be adopted to address potential concerns associated with gift cards do not create unintentional problems or adverse impacts in other consequences on other products which are operating efficiently.

2. Definitions: 'open-loop' and 'closed-loop'

The CCAAC white paper examines issues in relation to the purchase and use of gift cards in Australia and also seeks views on international approaches to regulating gift cards.

In the discussion that follows, we use the term "closed-loop gift cards" to refer to prepaid cards that are usable only at a single retailer or group of affiliated retailers. Typically, these cards are issued by the retailer and sold by the retailer.

We use the term "open-loop gift cards" to refer to prepaid cards that are marketed as a gift, but that are issued by financial institutions, sometimes in partnership with retailers, and operate over payment card networks, such as MasterCard, and may be used at any location where the relevant payment card network brand is accepted.

With these definitions in mind, the overwhelming majority of issues and public discussion about consumer detriment have stemmed from closed-loop gift cards, especially in the unfortunate circumstance of retailer insolvency or collapse. We believe that open-loop products offer additional benefits to both consumers and retailers and, as a result, our core consumer prepaid product offering is focused on reloadable open-loop prepaid solutions.

From both a public policy and economic perspective, we strongly believe that greater adoption of open-loop products will substantially alleviate most limitations inherent in closed-loop systems, including, most importantly, those associated with the risk of an insolvency.

3. Development and growth of prepaid products

Over the past decade, prepaid cards products and services have gained significant momentum as a new payments category that has vast and global potential to drive strong growth in commerce.

Advances in technology and communications have opened to consumers many new access channels and created new environments in which prepaid cards can be used. Today, for nearly every payments occasion, there is a prepaid solution that meets a consumer needs – and with more security and convenience than cash or cheques.

Since introducing its first prepaid card in the mid-1990s, MasterCard has become a leading prepaid payment card brand that is recognised, accepted and trusted around the globe.

Today, MasterCard combines a set of global prepaid product solutions, processing and advisory services that is unique in the industry and makes MasterCard a valuable business partner for companies looking to successfully participate in the prepaid market.

MasterCard prepaid card solutions enable:

- Global financial inclusion and an additional payment choice for consumers;
- Cost savings and greater efficiency for businesses and public sector agencies;
- Enhanced opportunities for retailers to displace cash, grow, be profitable and succeed;
- Innovations in emerging payments opportunities for retail banks and their customers.

4. Benefits of open-loop prepaid products

Open-loop prepaid cards provide significant benefits to many stakeholders.

Consumers: Open-loop prepaid cards give consumers more choice as well as convenient, flexible and secure access to funds. General use open-loop prepaid cards in particular provide consumers with a means to take control of their spending, including simplified money handling, budget tracking and bill payment. With open-loop prepaid cards, consumers can immediately access funds at retailer locations that accept MasterCard-branded payment cards. These cards provide a more secure and convenient alternative to cash.

Public Sector: Public sector open-loop prepaid card programs simplify the process for distributing consumer payments at all levels of government, including emergency and disaster relief payments, tax refunds, benefits payments, offsets and refunds, government agency payroll and transportation.

By upgrading government-to-consumer payments from paper cheques to reloadable open-loop prepaid cards, governments can distribute funds quickly and improve service delivery to their constituents, save money, demonstrate transparency and reduce fraud.

Corporations: Whether replacing payroll cheques or delivering meal vouchers or healthcare benefits, open-loop prepaid cards allow companies to reduce costs, effectively control business spending and create a better experience for their employees.

Payroll cards enable employers to replace paper-based payroll fund distribution with a streamlined, cost-efficient, card-based system that complements the traditional services of a payroll processor. Payroll cards are far safer and more convenient than cash and they give employees greater security and control over their finances. Prepaid healthcare and employee benefits cards also enable companies to minimise paperwork, reduce costs, simplify administration, accurately track expenses and improve program efficiency.

Retailers: Today, MasterCard cards are accepted at approximately 33.3 million acceptance locations around the world. Globally, merchants understand the value that card acceptance provides to their customers and overall to their business and have made the choice not to rely on antiquated cheque-based systems or on the amount of cash people carry in their wallets in order to make a sale. Merchants also realise the role that card acceptance plays in internet and mobile commerce and that the ability of consumers to reach them is dependent on safe, secure and robust payments products, which include open-loop prepaid cards.

5. Safeguards and consumer protection

An important distinction between open-loop and closed-loop products is that consumers and retailers are afforded the greatest level of protection from loss or fraud when they use open-loop products such as MasterCard-branded prepaid cards for purchases. These are subject not only to our own comprehensive rules, but also stringent regulations and legislation that govern the operation of the global payments sector.

Because of these regulatory and other system-based protections, it is accurate to say that MasterCard-branded prepaid products protect cardholders from the loss of value in events like merchant insolvency which recently resulted in consumer detriment in Australia.

One key issue with closed-loop products is that consumers are far more directly exposed to a potential merchant insolvency because there is no trusted intermediary safeguarding the value they transfer, through prepayment, onto gift cards.

This is also true of potentially onerous fees or conditions that may be applied to closed-loop products.

Although retail merchant insolvencies recently generated a high level of media interest in Australia, it should also be remembered that more common business changes like mergers, sales or closures create circumstances that may result in the deterioration or loss of value for consumers of closed-loop products.

Conversely, open-loop prepaid products such as those carrying the MasterCard brand protect consumer value and provide consistent rules and conditions. These rules and conditions are clearly articulated so that they can be easily understood by all parties to a transaction.

In addition, open-loop prepaid cards allow:

- consumers to monitor their account and identify fraudulent transactions and;
- issuing institutions or program operators to detect or protect against abuses, fraud, money laundering, terrorist financing or other activities associated with financial crime, and where detected, block the relevant card from further use.

6. Important distinctions between products

MasterCard appreciates that legitimate concerns exist around the potential for consumer detriment inherent to closed-loop gift cards. This said, legislative and regulatory responses to mitigate consumer exposure must be crafted in such a way that they do not unintentionally create new problems.

In other jurisdictions, regulations that apply to gift cards use strict product definitions and generally reach only closed-loop products. Where open-loop products are covered, there are normally a range of exemptions so that gift card regulations do not interfere with other open-loop products (these exemptions are explained in more detail below within the section relating to the regulations currently existing in the United States and Canada).

We believe that in Australia there should be similar consideration given to creating a distinction between non-reloadable (low risk, low value) open-loop cards, on the one hand, and reloadable (higher value, and commensurate enhanced risk mitigation) open-loop cards, on the other hand, if only to take into account the already strict regulation of products issued by Australian Authorised Deposit-Taking Institutions (ADIs) by various Commonwealth regulatory bodies, including the Australian Prudential Regulatory Authority (APRA), Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia.

Any proposed regulations should also create exemptions for specific categories of prepaid open-loop cards, such as corporate and government card programs, travel and foreign currency cards, remittance programs and transit and public transport ticketing cards. These products are typically exempted in other jurisdictions.

7. Fees

The strong uptake and growth in use of prepaid cards is a clear demonstration from all stakeholders that the benefits and convenience afforded by such products – in a competitive marketplace – clearly outweighs the costs incurred by their use.

As prepaid products and programs develop and expand, we are seeing fee structures evolve as well. While MasterCard does not set cardholder fees or terms, MasterCard supports the imposition of reasonable fees to the extent there is adequate, clear and prior disclosure of such fees. For example, dormancy fees and other service fees, when properly disclosed prior to the purchase of the card, provide a means for card issuers, program managers and distributors to secure some return on investment and cover the ongoing administrative costs associated with maintaining prepaid accounts or managing and marketing the programs.

This model enables MasterCard and the ADIs that issue MasterCard-branded cards to provide highly secure open-loop products that are compliant with stringent global payment industry standards including PCI-DSS (Payment Card Industry-Data Security Standard) that protect consumers and merchants alike.

Conversely, a merchant which issues a closed-loop product derives revenue not only from the value of the card (which must be spent at that merchant) but also from interest generated by carrying the float and the additional purchases that consumers usually make over and above the already loaded value.

However, in all circumstances, we recommend that all fees be adequately disclosed and that consumers be given the opportunity to read and understand the terms and conditions of prepaid card products before using them.

8. Expiry, breakage and security

The issue of expiry dates on gift cards and vouchers has in Australia recently been the subject of discussion, especially when merchants impose and enforce relatively short validity periods that consumers may not anticipate.

It is understandable that consumers become aggrieved when they are not able to redeem the value of a gift card or voucher they receive because it expired sooner than reasonably could have been expected.

In the case of closed-loop gift cards or vouchers, such scenarios at best suggest an inadequate communication or awareness of conditions by the merchant; at worst they suggest a degree of predatory merchant behaviour. They are not desirable in any event and note that, for instance, the ASIC's ePayments Code (subscription to which is voluntary) mandates for stored value card products a minimum expiry period of 12 months from either the date of issue or activation.

As previously stated, MasterCard believes that the nature of open-loop prepaid products helps to mitigate against such problems. For open-loop prepaid products to provide innovative and global functionality and still remain economically viable, however, modest fees need be applied by the issuing institution. These include up-front fees for activation and dormancy fees that apply after a prescribed period (known as breakage). Moreover, the concept of charging for account dormancy or inactivity is well established across the financial services industry and has for several decades been routinely applied to bank accounts – well before payment cards became common. Such mechanisms exist because there are attendant costs incurred when maintaining inactive accounts or products.

It is also essential to recognise that bank-issued non-prepaid payment cards (which are typically open-loop) use an expiry date as a fundamental security element to guard against misuse and fraud. These expiry dates are routinely used to help validate and complete transactions without having any direct bearing on the underlying funds.

MasterCard believes that expiry dates are an essential security element, which should be addressed by any potential regulation of gift cards in Australia and we would support requiring that a reasonable period of time from either the date of card issuance or activation has passed prior to imposing any account dormancy or inactivity fees.

9. Regulation of gift cards in the U.S.

The discussion below provides a high-level description of how gift cards are regulated in the United States. We use the term "closed-loop gift cards" to refer to prepaid cards that are usable only at a single merchant or group of affiliated merchants. Typically, these cards are issued by the merchant and sold by the merchant. We use the term "open-loop gift cards" to refer to prepaid cards that are marketed as gift cards, but that are issued by financial institutions and operate over card networks such as MasterCard, Visa, American Express or Discover, and may be used at any location where these brands are accepted.

Regulations Implementing Title IV of the Credit Card Accountability Responsibility and Disclosure Act of 2009

On April 1, 2010, the Board of Governors of the Federal Reserve System published a final rule (the "Rule") regarding gift cards and other prepaid products.[1] The Rule implemented certain provisions of Title IV of the Credit Card Accountability Responsibility and Disclosure Act of 2009.[2]

Generally, the Rule establishes restrictions on dormancy, inactivity, and service fees in connection with gift cards and certain other types of prepaid cards. The Rule also imposes expiration date restrictions on such cards and requires certain on-card and other disclosures to consumers in connection with the distribution of such cards. Importantly, the Rule provides an exemption for (i) prepaid cards that are reloadable and not marketed or labelled as a gift; or (ii) prepaid cards that are for loyalty, award or promotional programs and that include certain disclosures.

The Rule generally prohibits the imposition of dormancy, inactivity, and service fees (*e.g.,* monthly maintenance fees, transaction fees, ATM fees, reload fees, foreign currency transaction fees, and balance inquiry fees) with respect to cards covered by the Rule, unless: (i) there has been no activity with respect to the card in the one year period ending on the date on which the fee is imposed; (ii) certain on-card disclosure requirements are met; and (iii) not more than one such fee is imposed in any calendar month.

The term "activity" is defined as any action that results in an increase or decrease of the funds underlying the card, other than the imposition of a fee, or an adjustment due to an error or a reversal of a prior transaction.

One-time fees or a fee that is unlikely to be imposed more than once while the underlying funds are still valid, such as an initial issuance fee, a cash-out fee, a supplemental card fee, or a lost or stolen card replacement fee remain permissible. The practical effect of the fee restrictions is to prohibit transaction-based fees.

The Rule also requires that issuers and sellers of covered cards: (i) establish policies and procedures to provide consumers with a reasonable opportunity to purchase a card with at least five years remaining until the card expiration date; (ii) ensure the expiration date for the underlying funds is at least the later of five years after the date the card was

[1] *See* 75 Fed. Reg. 16,580 (April 1, 2010), *available at:* http://edocket.access.gpo.gov/2010/pdf/2010-6759.pdf

[2] *See* Pub. L. No. 111-24, 123 Stat. 1734 (May 22, 2009); *available at:* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=721389f5-62b0-46b5-b855-85621d0a8d69

initially issued or the date on which funds were last loaded, or the card expiration date (if any); (iii) ensure applicable on-card disclosure requirements are met; and (iv) when a card expires but the underlying funds do not, ensure that no fee or charge is imposed for replacing the card or for providing the cardholder with the remaining balance (*e.g.,* by cheque).

A "reasonable opportunity" to purchase a gift card with at least five years remaining means that the policies and procedures of the issuers and sellers must ensure the sale of a card that is good for at least five years after it was sold or initially issued, or that the product may be purchased five and a half years before the card's expiration date.

The Rule also establishes a safe harbour, under which a gift card that bears an expiration date that is at least seven years from the date of manufacture (*i.e.,* when the card is imprinted) generally does not require on-card disclosures that explain the relationship between a card's expiration date and the expiration of the underlying funds.

Prior to purchasing a gift card, the seller or issuer must disclose specified information in connection with the fee and expiration date restrictions and certain additional information. Disclosed fees, terms and conditions of expiration may not be changed after purchase. Certain disclosures must be placed on the front of a card.

U.S. State Laws Regulating Gift Cards

Most state gift card laws cover closed-loop gift cards while excluding open-loop gift cards. Similar to the Rule at the federal level, these laws may include a restriction on card expiration, a prohibition or restriction on card fees and specific disclosure requirements. State attorneys general have the authority to enforce these laws. Also, state attorneys general are empowered to enforce state unfair and deceptive acts and practices laws, which could be used to attack unfair or deceptive gift card practices.

Other Sources of Authority over Gift Cards in the U.S.

On June 23, 2011, the Bureau of Consumer Financial Protection (the "CFPB") issued a notice and request for comment ("Notice") on defining the non-bank entities that will be subject to CFPB supervision as "larger participants" in a market for consumer financial products or services (the "CFPB Rule") under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[3]

According to the Notice, financial service providers in prepaid card markets (including gift cards) may be subject to supervision by the CFPB if the market ends up being included as a designated market, and the financial service provider is considered a larger participant in that market under the CFPB Rule. While the CFPB has noted that the CFPB Rule would only cover participants that exercise "substantial control" over the terms or conditions of a card, the CFPB Rule has not yet been proposed, and so the details regarding the CFPB's supervision over gift cards is yet to be determined.

10. Regulation of gift cards in Canada

Gift Card and Prepaid Legislation

All provincial governments have passed legislation that bans expiry dates and/or regulates fees on gift cards and prepaid cards, subject to regulations which can provide

[3] *See* 76 Fed. Reg. 38,059 (June 29, 2011), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2011-06-29/pdf/2011-15984.pdf

exemptions to certain classes of prepaid cards The Federal Government announced plans to regulate network-branded prepaid cards in the 2011 Budget.

Most provinces are taking the position that MasterCard-branded prepaid cards are not covered by the fee limits within the legislation because they are issued by federally regulated financial institutions. Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, PEI and Quebec have clearly stated this exemption.

Ends