

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The word "WikiLeaks" is written in white on a dark blue rectangular background at the bottom of the graphic.

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February 2, 2009

Congressional Research Service

Report RS22431

Gift Cards

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October 5, 2007

Abstract. Terms and conditions (including fees, lost or stolen card policies, and expiration dates) for individual card products vary. Gift card programs have different features and applications. In addition, the varying capabilities of merchants' data processing systems can affect card usage. This can be confusing to both recipients and givers. Federal regulators have responded to concerns. Advisories were issued providing consumers with information and tips on gift cards. In addition, regulatory guidance articulates practices to be followed by financial institutions that establish and administer gift card programs. Some states have consumer protection laws that cover gift cards. Consumer advocates have urged Congress to create a set of national disclosure standards for gift cards and to curb or prohibit fees.

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Congressional Research Service

7-5700

www.crs.gov

RS22431

CRS Report for Congress

Prepared for Members and Committees of Congress

Summary

A gift card is a prepaid financial product that can serve as a replacement for a paper-based payment instrument such as a gift certificate. Current federal consumer protection laws do not regulate gift card programs. Typically, a gift card is a credit card-sized piece of plastic with a preloaded value. First introduced as closed-system prepaid products, gift cards were redeemable at a single merchant or at a set of locations, such as a retail chain. These were followed by open-system cards (also called “branded”) that can generally be used at any merchant location connected to the card’s payment network (Visa, MasterCard, American Express, or Discover). Gift cards are becoming increasingly popular with consumers.

Terms and conditions (including fees, lost or stolen card policies, and expiration dates) for individual card products vary. Gift card programs have different features and applications. In addition, the varying capabilities of merchants’ data processing systems can affect card usage. This can be confusing to both recipients and givers. Federal regulators have responded to concerns. Advisories were issued providing consumers with information and tips on gift cards. In addition, regulatory guidance articulates practices to be followed by financial institutions that establish and administer gift card programs. Some states have consumer protection laws that cover gift cards. Consumer advocates have urged Congress to create a set of national disclosure standards for gift cards and to curb or prohibit fees. This report will be updated as warranted.

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Background

In the United States, gift cards were introduced in the 1990s and are currently a large and growing business. According to one estimate, gift card sales were expected to exceed \$80 billion in 2006.¹ Approximately 30% of gift cards are purchased during the Christmas season (between the day after Thanksgiving and Christmas Eve).² Sales of gift cards exceeded \$27 billion during the 2006 Christmas season.³ Gift cards are part of a wide-ranging variety of stored-value payment products that include transit, disaster-relief, travel, medical benefit, and payroll cards. The card is usually made of plastic and is the size of a credit card. The cards are loaded with a prepaid value. Prepaid cards serve as a replacement for paper-based financial products such as gift certificates, transit tickets, tokens, currency, and paper checks.

Generally, gift cards fall into two broad categories: closed-system and open-system. Closed-system gift cards are issued by retailers and are purchased from and redeemable at a single store location or a merchant chain. Some retail gift cards can also be purchased and redeemed online. Merchants have also marketed their gift card products to customers as a fast and easy way to make reoccurring purchases (e.g., a morning cup of coffee or groceries) or simply as a convenient substitute for cash. The merchant point-of-sale (POS) electronic terminal must be programed to accept the gift card. Third-party processors support the operational requirements. After each transaction, the amount of the purchase is deducted and the card stores any remaining value. Merchants do not refund cash. Often, the cards are sold in fixed amounts (e.g., \$25, \$50, or \$100), and there is a maximum on the total card value. Some closed-system cards may be reloaded.

Open-system gift cards are branded with the logo of a payment card network, such as American Express, Discover, MasterCard, or Visa. A major difference between closed- and open-system cards is that the latter offer the possibility and flexibility of being redeemed anywhere the card's logo is accepted. The prepaid card transactions are authorized and settled by using the payment networks established for traditional credit and debit cards. Open-system gift cards can be purchased from participating providers, including banks, thrifts, and retailers. The prepaid cards can be purchased and used online, over the phone, or in person. The maximum total value for a gift card is established by the card issuer. Each time the card is used, the amount of the purchase is deducted from the card balance. Open-system cards can be reloaded. In addition, some open-system card programs allow cash back from a retail purchase and may include ATM (automated teller machine) access as a option. As new applications and innovations for open-system cards emerge, the potential range of differentiation among individual prepaid gift card programs increases.

The functionality of both types of gift cards depends on the sophistication of the merchant's POS terminal processing system. Merchants may not be able to tell gift card holders how much money remains on their card. Consumers may have to verify their remaining balance online or by phone. The handling of a shortfall when the card's balance cannot cover a purchase may also be problematic. A card may be automatically rejected if the purchase amount is greater than the

¹ *Gift Cards Fees Could Be Targets Of New Congress*. ATM & Debit News, Dec. 7, 2006, p. 5.

² *Ibid.*, p. 5.

³ Bureau of National Affairs, *Daily Report for Executives*, Jan. 25, 2007, no. 16, p. EE-2.

balance. A merchant's terminal may be incapable of handling more than one form of payment for the same transaction. If a card cannot be reloaded, a consumer may find it difficult to spend the card's entire value.

Currently, federal consumer protection laws do not regulate gift card programs. Consumer advocates have urged the Federal Reserve System to extend the provisions of Regulation E to cover all types stored-value or prepaid card products. Regulation E implements the Electronic Funds Transfer Act,⁴ which establishes the rights, responsibilities, and liabilities for participants using electronic fund transfers systems (e.g., ATMs and POS terminals). Regulation E protections include initial disclosures, periodic statements, and error resolution rights. Federal financial regulatory agencies have traditionally exercised restraint in regulating new financial products because premature regulation could stifle innovation. The regulators closely monitor new banking activities to ensure safety and the soundness of financial institutions. They may issue guidance for the depository financial institutions they regulate and/or consumers. The variety of prepaid card products, and therefore the types and degrees of risk they present to cardholders and issuers, complicates regulation of these payment instruments with a "one-size-fits-all" approach. On August 24, 2006, the Federal Reserve issued a final rule⁵ that makes one sector of prepaid cards—payroll card products—subject to Regulation E. These cards were singled out because of certain characteristics, including that they "represent a recurring stream of payments that is likely the primary source of the consumer's income.... They are replenished on a recurring basis and designed for ongoing use at multiple locations."⁶ The Federal Reserve stated that gift cards and other prepaid cards were not covered, in part, because these products are generally not intended to be held and used over a long period of time. In addition, the funds held on individual cards were minimal. The costs to the issuer of providing Regulation E protections are significant.

Gift cards are addressed by the laws of some states, and those states vary in their treatment. Some state consumer protection laws prohibit or set a time limit for an expiration date. Various types of fees are addressed in different ways (some prohibited and some capped). A number of states have adopted escheat laws. These laws determine who can claim the value of an "abandoned" or unused gift card (the consumer, the vendor, or the state government). Escheat laws generally presume abandonment after a stated number of years. The National Conference of State Legislatures (NCSL) tracks state statutes covering gift cards and gift certificates.⁷

Consumer advocates have raised concerns about the problems resulting from inadequate consumer disclosure protections provided by gift card programs. The National Retail Federation has suggested that uniform federal disclosures might be preferable to regulation on a state-by-state basis. The Gift Card Protection Act (H.R. 85), introduced in the 109th Congress on January 4, 2005, by Representative Rodney P. Frelinghuysen, and referred to the Subcommittee on Commerce, Trade and Consumer Protection of the House Committee on Energy and Commerce, would have prohibited expiration dates, service charges, and dormancy fees on gift certificates. The bill's definition of "gift certificate" included prepaid, stored-value electronic cards. No action beyond subcommittee referral was taken on the bill, nor has similar legislation been introduced to date in the 110th Congress.

⁴ 15 U.S.C. 1693.

⁵ Regulation E amendments are available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20060824a1.pdf>.

⁶ *Ibid.*, p. 6.

⁷ Information can be found on the NCSL website at <http://www.ncsl.org/programs/banking/GiftCardsandCerts.htm>.

Policy Issues and Regulatory Response

The rapid growth of the market indicates that gift cards have found wide acceptance among merchants and their customers. Nevertheless, the popularity of gift cards raises a number of consumer protection issues, generally involving charges and terms, of which consumers may be unaware. The issue of adequate disclosure is complicated by the fact that the buyer of the card is often not the ultimate card user.

The terms and conditions of individual gift card programs in both open and closed systems can vary significantly. Factors include card acceptance, fees, expiration dates, a lost/stolen card policy, a return policy, and the process used to file a complaint. Consumer advocates express concern that gift card programs do not universally provide adequate, clear disclosure to both the giver and receiver of a gift card. Of special concern are the expiration dates and various types and amounts of fees. Expiration dates are not generally printed on the card. Not all cards have an expiration date, and those that do may allow the cardholder to extend the date, usually for a fee. Fees connected to gift cards include purchase fees, activation fees, inactivity or dormancy fees, transaction fees, monthly maintenance fees, inquiry fees, and delivery fees for cards bought online or by phone. The amounts charged vary. It is possible to lose a significant portion of the gift card's value to these charges. Expiration dates and dormancy fees are particularly unpopular with consumers. Consumers may view an old gift card as an interest-free loan to the merchant or card provider. In general, terms and fees are defended as being in line with charges and terms associated with checking accounts and other financial products. The regulatory response to these consumer protection issues are set out below.

Consumer Advisories

Three federal regulators, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the Federal Trade Commission (FTC), have issued consumer alerts providing advice on the potential pitfalls that may be associated with gift card programs. The alerts provide tips on what card issuers should disclose. The OCC and the OTS are offices within the U.S. Treasury Department. The OCC charters, regulates, and supervises national banks and the OTS regulates and supervises the U.S. thrift industry. The OCC's advisory, *Gift Cards: OCC Provides Holiday Tips for Consumers*, was first issued in December 2004.⁸ The OTS's advisory brochure, *Consumer Fact Sheet: Buying, Giving, and Using Gift Cards*, was issued in February 2007.⁹ The advisories caution consumers giving or receiving gift cards to request and carefully check the terms and conditions connected to gift card programs. They warn consumers that programs differ and outline some of the most important features to check. The advisories highlight fees, expiration dates, card usage and replacement, and how to report problems.

The FTC is charged with enforcing laws that prohibit business practices that are anticompetitive, deceptive, or unfair to consumers and with promoting informed consumer choice. In December 2006, the FTC issued an updated alert titled *Buying, Giving, and Using Gift Cards*.¹⁰ The two-page alert outlines tips for buying and using gift cards. It also has a section on how consumers

⁸ Available on the agency's website at <http://www.occ.treas.gov/ftp/release/2004-108a.pdf>.

⁹ Available on the agency's website at <http://www.ots.treas.gov/docs/4/480923.pdf>.

¹⁰ Available at <http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt010.htm>.

can file a complaint or resolve a problem. The FTC's enforcement work is done through administrative proceedings and in federal court actions. As of April 2007, the FTC had undertaken two law enforcement actions involving allegedly deceptive gift card sales.¹¹

Regulatory Guidance

Federal regulators of depository financial institutions issue guidance, in part, to advise institutions on emerging and significant risks and to articulate the regulators' expectations for institutional practices for managing those risks and preventing problems from arising. On August 14, 2006, the OCC issued guidance to national banks on marketing and disclosure issues raised by gift card programs.¹² On February 28, 2007, the OTS issued guidance on gift cards offered by OTS-regulated financial institutions.¹³ The agencies recognized that the rapid growth of the gift card market together with the assortment of fees and other terms and conditions required clear disclosure policies.

The guidance from the two agencies is similar with respect to consumer protection considerations. The guidelines recognize the need for both the purchaser and recipient to be fully informed. The guidance illustrates information the regulator would expect to see disclosed on the gift card itself (which may also be on an affixed sticker or tape) and in a separate set of disclosures that would accompany the gift card. The expiration date, the amount or the existence of fees, and contact information for customer service would be provided on the card. Disclosures accompanying the card would include the name of the issuing financial institution, additional fee information if applicable, where the card can be used, and what to do if the card is lost or stolen. Finally, the guidance addresses misleading marketing and promotional practices to be avoided.

The OTS guidance also stated that (1) thrift institutions should consider anti-money-laundering laws, regulations, and guidance for reporting suspicious activities in connection with their gift card programs; and (2) institutions that issue open-system gift card products should develop systems to apply the customer identification program to these products.

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¹¹ For information on the two cases see <http://www.ftc.gov/opa/2007/03/kmart.shtm> and <http://www.ftc.gov/opa/2007/04/darden.shtm>.

¹² The full text of the guidance can be found at <http://www.occ.treas.gov/ftp/bulletin/2006-34.txt>.

¹³ The full text of the guidance can be found at <http://www.ots.treas.gov/docs/7/777012.html>.