

Rule by regulatory mandarins is not only unconstitutional, it suppresses payments competition and innovation, and consequently consumer choice and value.

The CFPB's New Prepaid Rule: The Good, the Bad, And the Ugly

The proposal would do some useful things, but that advantage is outweighed by its—and the Bureau's—disadvantages, says Eric Grover.

On Nov. 13, the Consumer Financial Protection Bureau released its long-anticipated proposed rule regulating prepaid payment products. As is the Bureau's wont, the rule is exhaustive in its self-justification and its prescriptions for a broadly defined prepaid industry. There's the good, the bad, and the ugly.

First, the good. Much of the proposal is eminently reasonable. The provisions requiring fraud-and-lost-card protection, error resolution, easy-access account information through periodic statements and/or online access, standardized disclosures, and credit restrictions consistent with the Truth in Lending Act (TILA) all seem like Mom, God, and Apple Pie.

Take the rule's position on the vexed question of offering credit. Credit has been treated inconsistently by regulators. By administrative fiat, the Fed has said overdrafts are credit for purposes of the Equal Credit Opportunity Act, but not for TILA. No statute says demand-deposit overdraft facilities aren't credit.

Regulators, along with a chorus of self-anointed consumer activists, have long been hostile to the prepaid industry providing credit. In 2010 and 2011, federal banking regulators ordered prepaid card issuer MetaBank to close its iAdvance credit program because of allegedly unfair and deceptive practices, reimburse \$4.8 million in fees and pay a \$400,000 fine.

The rule would provide certainty and a green

light to offer credit, along with a modicum of regulatory consistency on the matter.

The Bureau's rule would also cover overdraft and credit lines associated with prepaid products and forced-pay transactions where there are sufficient funds at initial authorization for a car rental or hotel, but not when the merchant seeks payment, and subject them to TILA and credit card law.

While reloadable general-purpose prepaid cards are a great product for millions of unbanked and underbanked—a term used by the Federal Deposit Insurance Corp. to denote banked consumers using financial products of which it disapproves—their economics are difficult compared with credit and debit cards. Prepaid spend is lower and account turnover much higher.

To address the business model's challenges, providers added bill payment, check writing, and standard DDA features to persuade cardholders to use prepaid accounts as their banking platform, thereby increasing payment volume and reducing churn. To skirt the Durbin Amendment's interchange controls, they limit features or use politically sympathetic exempt issuers with under \$10 billion in assets.

Here again, the proposed rule is useful. Providing hybrid prepaid/credit products boosts revenue, serves an often unmet need, and offers millions a path to establish credit.

Now for the bad. While the industry needs rules, regulation comes at a cost,



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which ultimately consumers bear. The Bureau's blanket of minute prescriptions reminds me of the European Commission's regulation No. 2257/94, which stated bananas must be "free of abnormal curvature" and at least 14 cm long. Similarly, the Bureau proposes URLs linking to variable-fee disclosures can't be more than 22 characters.

The rule would cover reloadable general-purpose prepaid cards, payroll and many government benefit cards, and a host of evolving digital wallets, person-to-person payment systems, and cryptocurrency products.

Indeed, former NetSpend general counsel Christopher Brown worries it will "trap the burgeoning ecology of next-generation digital wallets and cryptocurrency innovations in a consumer-protection regime narrowly tailored to the unique characteristics of reloadable prepaid cards sold to underbanked consumers" and that disclosure boxes for cards sold on Wal-Mart j-hooks aren't the best model for digital wallets.

The Bureau overlords' regulation straightjacket, however well crafted,

will put a damper on experimental innovation and create a defensive moat for incumbents with scale. Not unlike with the common law, human experience in the market is a better evolutionary path to develop rules than clever Washington mandarins.

Finally, we come to the ugly: the power vested in agencies like the CFPB. Financial-services executives won't publicly criticize the Bureau because it has plenary power over them and can destroy businesses. It's chilling and unhealthy when the subjects of regulation are not free to criticize administrative agencies for fear of retribution.

So the industry has alternately held its tongue and kissed the regulators' rings.

Congress legislates, the executive enforces and the judiciary adjudicates. Congress can delegate implementation of, but not the making of, binding law.

Columbia law professor Philip Hamburger makes a cogent argument that administrative law is unlawful. "The administrative regime consolidates in one branch of government

the powers that the Constitution allocates to different branches. Administrative power thus brings back to life three basic elements of absolute power. It is extralegal, suprallegal, and consolidated."

If the Bureau rules prepaid specialists cannot offer credit to their customers for 30 days, it's making—not implementing—law. If the legislature wanted to forbid it, it could. It's hard, however, to imagine politically accountable Congress denying men and women who can vote, serve on juries, and join the army the right to voluntarily contract for credit.

In short, the Bureau epitomizes absolutism at odds with the Constitution's separation of powers. It's legislating, enforcing, and adjudicating, not just implementing, law. Moreover, while Congress is supposed to have the power of the purse, the Bureau was funded out of the Fed to stymie Congressional oversight.

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