



# **The Evolution of Prepaid Instruments from Giftcards to Virtual Money Laundering in a Global Theatre and its Implications for Financial Inclusion Programming**

**Q & A Session**

**October 18, 2012**

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*Female:* We're going to open up the Q&A session. We're probably going to start off with some webinar folks but I wanted to let you know that we have 50 online folks from places like Laos, Baghdad, Pakistan, New Jersey, *[Laughter]* the University of Maryland, and the Federal Reserve Bank. So let's start off with a webinar question.

*Female:* We're going to start off with these only because these folks cut out earlier than you all. We want to capture them sooner rather than later.

*Female:* We have one from Irene Philippe. She's the Resident Advisor for U.S. Treasury Office of Technical Assistance. She has a couple of loaded questions so if you can bear with me. Is there a basic prepaid card regulation that you would recommend as best practice for emerging markets willing to regulate these new payment mechanisms? And she comment, "Most emerging markets consider prepaid cards as being under the responsibility of a central bank, not the Superintendents of financial regulation. However these new products carry risks that are new to traditional payment systems. How would you advise this is managed with regulation institutions?"

*Female:* To be honest with you I'm only aware of one regulation out there right now that has to do with prepaid cards and that's the United States regulation. We tried – The regulation, which Vincent will tell you, was driven by law enforcement – Industry itself hates the regulation because it is not risk-based. It's very strict compliance-based. We decided that prepaid cards as a whole were such a risk that it wouldn't be risk-based. For general purpose reloadable cards customer identification has to be done on each one.

Now that customer identification of course is never face to face so that in itself makes it somewhat risky. It's either done over the phone or via computer. And, to give industry credit, they do their best in trying to validate the information. We have some very unique databases for emerging markets to be able to validate that identity. When it's not face to face it's going to be very difficult because you don't have LexusNexis and Esperian® and some of those where we can validate the information very quickly. In milliseconds it can be validated. That's going to be a problem.

In also validating identify they ask what they call wallet questions, which once again, because of the information that we have on people that they can very easily query through the internet, it makes the validation of those wallet questions easy to do. But in an emerging market type situation that's going to be very difficult. Either the customer identification is going to have to be done right on site when it's sold, so the seller is going to have to be responsible for that.

Here in the United States the seller is considered to be an agent of the prepaid card issuer or provider. But they do not have to do customer identification unless somebody's buying more than \$10,000.00. So that may be a solution. If the card is being sold for more than \$750.00 or \$1,000.00 then the seller has to do the customer identification. And then that goes on to the issuer.

*Female:* Another point to supplement this for Irene. You can have the regulations, but again, look at the list that I handed out and look at those countries to see if there's the capacity to monitor in force the very regulations that they might have. That's really a gap that I see.

*Male:* I was hoping you could elaborate on the combination of Bitcoin and M-Pesa. M-Pesa is already largely anonymous. Bitcoin is already anonymous. So what does the combination of these two anonymous things get you that using either one of them individually don't get you?

*Female:* I think I would take slight issue with the comment that M-Pesa is anonymous, and we can discuss that (Peter) later, but the concern with the hybrid is that Bitcoin piece because that could put an anonymous fund source into an otherwise potentially traceable funding conduit. So I think that's the concern with it. And then the other concern that I have with that model being aggressively marketed within one marketplace (the African marketplace) is again, look at the capacities.

Does the capacity exist within the informal non- bank regulated legal regulatory and enforcement context to actually trace the funds going through that type of hybrid model? I think that M-Pesa can be traced to a great extent. We have folks like Loretta Michaels here who can speak with pretty good authority on that. I think it's the combination of the Bitcoin plus the M-Pesa that makes it more challenging. And I can give you a small case study on that that might illustrate that.

*Female:* Could I add something very quickly? The real benefit is that basically it's not Bitcoin teaming with M-Pesa, it's Bitcoin development of an M-Pesa like system for Bitcoin. So the real benefit is that it's floating. It's not tied to any specific currency so that it would be perfect for cross-border transactions, which I think is one of the big pushes for it.

*Female:* Right. Just a note for the folks that are actually answering the questions or asking questions in the room to just identify yourself and your organization so that folks online will also know who you are. We'll take another question from the webinar.

*Female:* This question comes from Joel from New Jersey. He asks, "What two or three changes would you seek for a payment platform like Zoom to make,

assuming good intent on their part to operate professionally in a transparent and legal manner? Would membership to Egmont be a step?" And then we also have another one (and I apologize if I butcher your name) Stoychel who's joining us from Bulgaria.

He asks, "Do gift cards which can be used in a limited network of retailers and do not allow for cash to be withdrawn mitigate the money laundering risk?"

*Female:*

Let me first clarify what Egmont is. Egmont is essentially an international organization of financial intelligence units from different countries. It's not anything a private sector type entrepreneur could join. This is just the financial intelligence units that are part of a requirement of a proper anti-money laundering legal regime for a national currency. As far as the gift cards, as I said, the gift cards make it not as easy to launder money.

But because of the number of web sites that will purchase these gift cards at a discount – If you'll go onto eBay now these are being sold by the hundreds at a 10-20 percent discount. There are at least 10 different internet sites that will buy these sites at a discount. The largest of them is Plastic Jungle. Plastic Jungle does have an AML program. They realize that if somebody is trying to sell them 100 of these cards then it probably comes from a nefarious source as opposed to some kid that just wants the cash when they've gotten them for graduation or whatever.

A lot of it is – It's not going to stop the money laundering. Just the anonymity itself makes it very easy. And as we discussed, these new programs like Square and Intuit system that sits on your phone and Sale that sits on your phone enable money to be taken off of them and just put in your bank account. You're not getting cash off of them but money is moved from them.

*Male:*

But remember the fact that it says you can't use it for ATM doesn't really mean anything. The processor can pull one little switch and all of a sudden the same card now has ATM access as well as internet access as well as point of sale. It's up to the processor to monitor that access that they provide on the card.

*Female:*

In many ways the weakest link here is the processor, or the most vulnerable link here is the processors, because if they become corrupted and, at least here in the United States, the handling – just the processing of a transaction between a merchant is exempted from our regulations. So processors are not considered to be money service businesses here in the United States. And that's problematic because they don't have to have an anti-money laundering program. They don't have to monitor. Even

though they're the ones seeing the transactions they don't have to monitor the transactions.

*Male:* Hi. My name is Mondue and I'm from the Robert Smith School of Business. We're developing a mobile to mobile remittance service similar to Zoom. My question I guess is for each of the panelists in turn. Is there anything about Zoom that you with that perhaps they might've taken into consideration when they were developing the product? Or are there perhaps some aspects of a mobile to mobile remittance service that you'd like to see from a regulatory standpoint, from a technology standpoint, and perhaps just in general?

*Male:* Well remember Zoom is just an example. There are lots and lots of them. There are many, many Zooms in the world like Cobo and there are ones that specialize in countries. I think their technology is very good. They take a card and they run a purchase transaction. That's how they secure the funds.

And then they take those funds and they send an e-mail to the receiving country and say, "All right I've got my \$1,000.00 and you have yours." So I would say the technological side – they're very, very efficient and they're very good. They do what they're meant to do. International or global money remittance they do very well. I would say no, from the technology side they're really good. From the regulatory side I'll leave that up to Susan.

*Female:* I think in the creation of any of these new technologies you have to look from the anti-money laundering compliance which means I need to have transparency. You need to be able to monitor the transactions. You need to look at how the money is loaded into your system, the velocity of that load, how the money's being spent, where it's being spent, how the money travels back and forth. For the law enforcement end of it we need to be able to come to you and be able to get all that information.

You need to be able, in monitoring that information, to be able to tell us that something suspicious is going on. And, to protect yourself, if it goes on for too long, that you're going to stop it and close that kind of account down. As an example, Green Dot, as I said –These have become the chosen for advance fee fraud schemes. You get the phone call or you get the e-mail that says, "Hi you've won the Canadian lottery," even though you never entered the Canadian lottery or the Nigerian lottery.

And all you have to do is pay for the taxes. So you've won \$100,000,000.00 and you need to pay \$100,000.00 in taxes. It used to be you'd go make little trickle payments at Western Union. Western Union now has become very good at trying to filter out those types of

transactions. They've gone to this kind of mechanism. Well Green Dot has realized that and we have a huge problem with Jamaican advance fee fraud things. Well, they put stops.

No money can be pulled off their cards in Jamaica now because they saw that kind of activity going on and on in a country. So they'll stop money being taken off in a country. You have to be able to do that. If you're going to operate here in the United States there's those love OFAC filters – Office of Foreign Asset Controls. You've got to be able to build into your system, if it's going to operate in the United State, to be able to screen those kinds of transactions.

But also even if you're going to set it up overseas there are those U.N. names that you need to screen as well, for terrorist financing. That becomes a problem. But the biggest thing is to make your system transparent and to be able to monitor those transactions.

*Male:* Can a lot of those requirements be met [*inaudible comment*] processors, one way to adopt a program manager aspect to this?

*Female:* That's a really good question. Maybe you could repeat it into the microphone?

*Male:* Could those requirements be met if one were to adopt a program manager role and partner with a processor who already has all these systems in place, such as a bank or a financial institution, or perhaps there's a company that's already registered and has money transmit license in all the states in America?

*Male:* There are three legs to the proverbial stool. You've got the financial institution. You have the processor. And you have the program manager. Those are the three legs. As long as all three of those are operating with good intent and to not only meet, but exceed the legal and the regulatory requirements, yes all those can come together.

*Female:* We have a couple more questions from webinar. Jim Wells asks, "Is there any recognition within U.S. law enforcement that the lack of real time payment systems drives law abiding businesses and consumers to use alternatives?" And Nicky – she's a Gift Card Marketing Manager with Vantiv. Nicky asks, "How can credit card/gift card processors help with security as currencies become more virtual?"

*Male:* The fundamental difference between a gift card and incentive card is the non-reloadable feature of it. Whereas a GPR, general purpose payroll, they're reloadable with all the KYC. So the question was relative from Vantiv that was relative to gift cards. Gift cards are a popular way

particularly in human trafficking, particularly the coyotes in Arizona, child sex selling. The key for the processors of gift card is velocity.

Why are cards being used? How fast are they being used? What are the dollars that are being used? The key is to understand velocity and why and where they're being used. People generally don't buy gift cards one day for \$500.00 and use them for \$500.00 within four or five hours. In the adult prostitution world the John goes into a Walmart. He buys a gift card off the shelf. He goes to the pimp. He gives him the money. He has got the 800# memorized. He calls up. He confirms the balance and the transaction is completed.

There's no reason to buy a card and deplete the value on a card within an hour as a general hour. Looking at how they're done. Are they going through Square? We'll call those remote or electronic transactions. I would say that a processor for gift cards has a lot of intel that they could use and they need to use that all tied to velocity of the cards and the value of the cards overlaid with the frequency. The recency, the frequency, and the monetary aspects of that card are what are important.

*Female:*

I think the second question had to do with whether law enforcement recognized – because if you use the banking system to send a wire transfer it's probably going to take 2-3 days or 3-4 days. There's that's need for instantaneous types of transactions. Certainly we recognize that need and all we're requiring is that there be a very clear record of that so that we can then follow the money.

*Male:*

Christian McCrae, *Journal of Social Business*. I'm a little bit confused because I'd like to start from a different place and then maybe understand what your main advice for that would be. Essentially I'm thinking in USA terms that the future of banking, the next billion unbanked is going to be more and more to do with cashless banking, the M-Pesa systems, perhaps a big cash system in Bangladesh.

These are huge systems which need to be developed in their terms to try and end poverty and do the good stuff. What I'm hearing is that your expertise is one of the things that sort of interacts with perhaps how to either corrupt or perhaps also the good ways of using these things to connect with these systems. But I'm wondering where do the regulators across all the countries actually meet to discuss both what I'm interested in in my naïve thing of thinking that there can be good cashless banking, but also to take into account the kinds of problems you're raising?

I mean I believe there's an alliance with Financial Inclusion which is where the experts of M-Pesa's and B cashes sort of annually meet. But I

mean do you join in with them or a different association network? Where does this all come together?

*Female:*

For us on the main side it's at the Financial Action Taskforce. They are studying the typologies of new payment systems and trying to do – Currently they're +trying to get drafted best practices for prepaid cards and mobile technologies. And within those best practices of course they're looking totally from a terrorist financing and from an anti-money laundering perspective of what those best practices would do.

I'm hopeful that perhaps out of their meeting as we speak in Paris that out of this meeting perhaps they'll finally finalize those guidance's, which are then distributed out there to the public. Kenya and Bangladesh, while not - In a number of these emerging countries, while not members of FATF, they're almost all members of what we call FATF regional style bodies. So they must adhere to the FATF standards.

I know Kenya belongs to the East Africa/South African anti-money laundering group which is a regional body of FATF. But they all lag behind. As Maria has pointed out the biggest hick-up in all the anti-money laundering standards is the ability to enforce them. If you don't have the governmental capabilities of enforcing them they're just words on a piece of paper and that's probably the biggest problem.

Here in the United States our biggest problem is in regulating money service businesses. We regulate the banks and a lot of our financial institutions, stock brokers, those kinds of things very strictly. Money service businesses are a much more difficult thing for us just because of the quantity of them and the lack of bodies to examine them.

*Female:*

A couple of things. Susan mentioned FATF. There's the Financial Action Task Force and we have a representative at Treasury who represents the USG in that body and they're in Paris now.

*Female:*

Yeah we have three from Justice. It's a huge thing.

*Female:*

So that's a regular place for that type of interfacing. There's some very good language (it's still in draft form) that came out on technology-based risks. So hopefully once that comes out it can be publicly accessed. It's good guidance so far in draft. Egmont group we mentioned. Again, to become a member of Egmont you have to be sort of nominated by two existing Egmont members and you have to clear a rather stringent threshold to become a member of Egmont because what that allows the financial intelligence units to do is share information – real time information – within that group.



So it's a very effective way to share suspicious action reports and whatnot. But again, one of the things that I see as a potential problem is (and I don't have an answer for this) do the current members of Egmont and FATF and similar bodies have a common nomenclature and vocabulary to describe these types of transactions as they would in a bank-based system when we talk about deposits, remittance flows that are bank-based?

That's number one. The second thing is another forum that will be addressing this issue has already started to. It would be the normal standard setting bodies: Basel, CPSS, and the like. They've been a little bit busy of late kind of picking up the pieces of the global financial crisis. They're going to get to this in due time, but that would be, in my opinion, kind of a normal route through which these types of standard setting discussions would and should take place.

With input from the financial inclusion community, but again, in my opinion, the discussion I think needs to be driven by the normal standard setting bodies. And finally, again, I just have to go back to the point that I keep making that this really is a capacity issue because you can have FATF, you can have Egmont, you can have Basel, all these groups, talking and coming up with really good regulations and guidance.

But at the end of the day if you're sitting in Malawi and the bank-based financial intelligence unit with two people manning that FIU, how are you going to manage non-bank-based flows? You have to set up an effective parallel structure that needs to interface with that bank-based structure is just simply not there. So it really does boil down to the need for good standards and regulations alongside the capacity to animate them.

*Female:* Yeah I would just add to that, Maria, that between five and ten years ago a lot of the central banks in emerging markets were focused on upgrading their systemically-important systems like RTGS, etc. And there's been a great deal of progress on that. Now, literally within the last year or so and increasingly, the central banks are looking for help to modernize their retail payment systems.

So that's where a lot of this is coming in. But it's just beginning to be modernized. And as Maria said, there's a real lack of capacity out there.

*Female:* We have a question from Holly Smacker who is a Store Value Property Manager at Vantiv. Holly asks, "Do you see any pattern with respect to how quickly a gift card is activated than redeemed when used for fraudulent purposes so that we may be able to put measures in place to monitor?" And we have another one from Jim Wells who asks Susan, "Who's pushing for the next generation ACH-type solution for business

and consumer payments in the U.S.?" And he comments, "Apparently the banks and government are reluctant to satisfy this need on their own."

*Male:*

I think the two best sources of information for activity that's aggregated would be Mercator. I'd call Tim Sloan. I think he can provide some of those – I don't make anything off of that by the way. I just think he's got really good information at Mercator. And I think MasterCard and Visa themselves have gone out and aggregated data.

I think the best place to find that would be at the networks themselves and Mercator. And that should give you some ideas on the timelines. Then overlay that with what your own activity is that you're seeing on your gift cards.

*Female:*

The answer to the question is I don't know. I'm not aware. I'm sure some work is being done with NACHA regarding the ACH types of transactions. But because most – At least through the banks most of the international traffic has to go through correspondent relationships. That's to a certain extent what slows some of this down. And that's why you have the Western Unions and the MoneyGram® whose systems are internal to themselves as their ability to move money.

And of course now with these new mobile systems they're doing the same. They're creating their own systems outside of the ACH type of transactions. It probably is because of the sheer time it takes to do it.

*Female:*

Do we have any additional questions in the room? We don't have any more questions on that.

*Female:*

To follow up, because it just popped in my head, some of the Federal Reserve banks are experts in very specific areas. In the payment area I would look at the Federal Reserve site in Atlanta. They're in charge of the payment system and they come out every year with a very detailed report on how payments are moving through the United States.

And also I would look at the Philadelphia Fed Reserve. They also work with payments as well. And they recently just put out a report and had a big conference maybe three months ago and the use of prepaid cards and the use of mobile payments. Those might be things to look at and people to talk to at those Federal Reserve banks.

*Female:*

And I would make just one final point in terms of the next steps. I think there's a lot of need for research on the types of issues that we've brought forth this morning. One of the challenges in trying to do research to try to trace these transaction flows is really access to the data. If you're talking about trying to access data you want to access to Country X from Country

Y and you want to get this data in a non-bank-based system there are going to be jurisdictional issues.

There are going to be proprietary issues, –

*Female:* Privacy issues.

*Female:* privacy issues that are going to make it really challenging to get time sensitive data that you can use quickly that may not necessarily be the case if you're talking about a correspondent bank to bank process. So those are some very practical issues that I think investigators are probably already facing right now.

*Female:* For ten years we've been trying – HIS or ICE or DHS, whatever you want to call them today – They've created what we call a trade transparency unit which has a wonderful program for receiving trade information from one country and sharing with another and then mashing it together to see what doesn't meet up. We've had that since the mid-90's. They're just now getting it and it's free.

It's not like we're charging for it. But most countries don't want to give their trade data up like that. It's become problematic. Columbia and the United States have been sharing data for a number of years. But we've been trying to get Panama to do it for many years. They've finally agreed but those kinds of – Just for trade data – and trade data is much more open than when you're talking about financial data. That also becomes problematic.

*Male:* My last comment is how exciting it is to be in prepaid right now. I mean you look at guys like American Express that I never would've thought would've come out with like a Bluebird product at a Walmart. And this is financial services on a card. There are tens of millions of people who really use these cards. Social Security Administration has its Direct Express. There are a lot of programs.

So I guess one final thought is let's not mix those who use these cards for financial services. They're inclusion and we'll call it the unbanked banking system. And they use them for bill payment because the banks – Remember the banks acquiesce this customer. What's important is that those are stepping in. We've talked about whether it's international or whether it's just in the United States. I have always been saying, "We need a champion."

I think AmEx is going to make a statement with Bluebird. I think Chase is going to make it with their product called Liquid and you're going to see others. And so now we're finally going to see this un-bank, because

there's un-bank, there's under-banked and there's "I used to be banked."  
There's a large group in this country that used to have a house, that used to have bank accounts.

And they're on the road to recovering. We have some good things lying ahead. The other side of this is not to impede the development. A very good financial tool as we look at inclusion and the financial arena (let's just call it that) – I can argue that it's better to have a prepaid card with Chase that I bought at Walmart than it is to have a bank account at Wells Fargo.

I think it's exciting to see that. I think there are new things on the horizon. And our goal here is to stay very much aware of the opportunities but also be aware that whenever there's great opportunity there are those who will try to take advantage of that opportunity. With that, thank you.

*Female:*

On behalf of USAID as well as KDMD we want to thank you for coming in person and online. The screencast will up on the Microlinks web site if you registered online. You can go back to the event page and any additional resources that Maria, Jack, or Susan would like to put up there as well will be there. So we want to thank you and everybody have a great day.

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