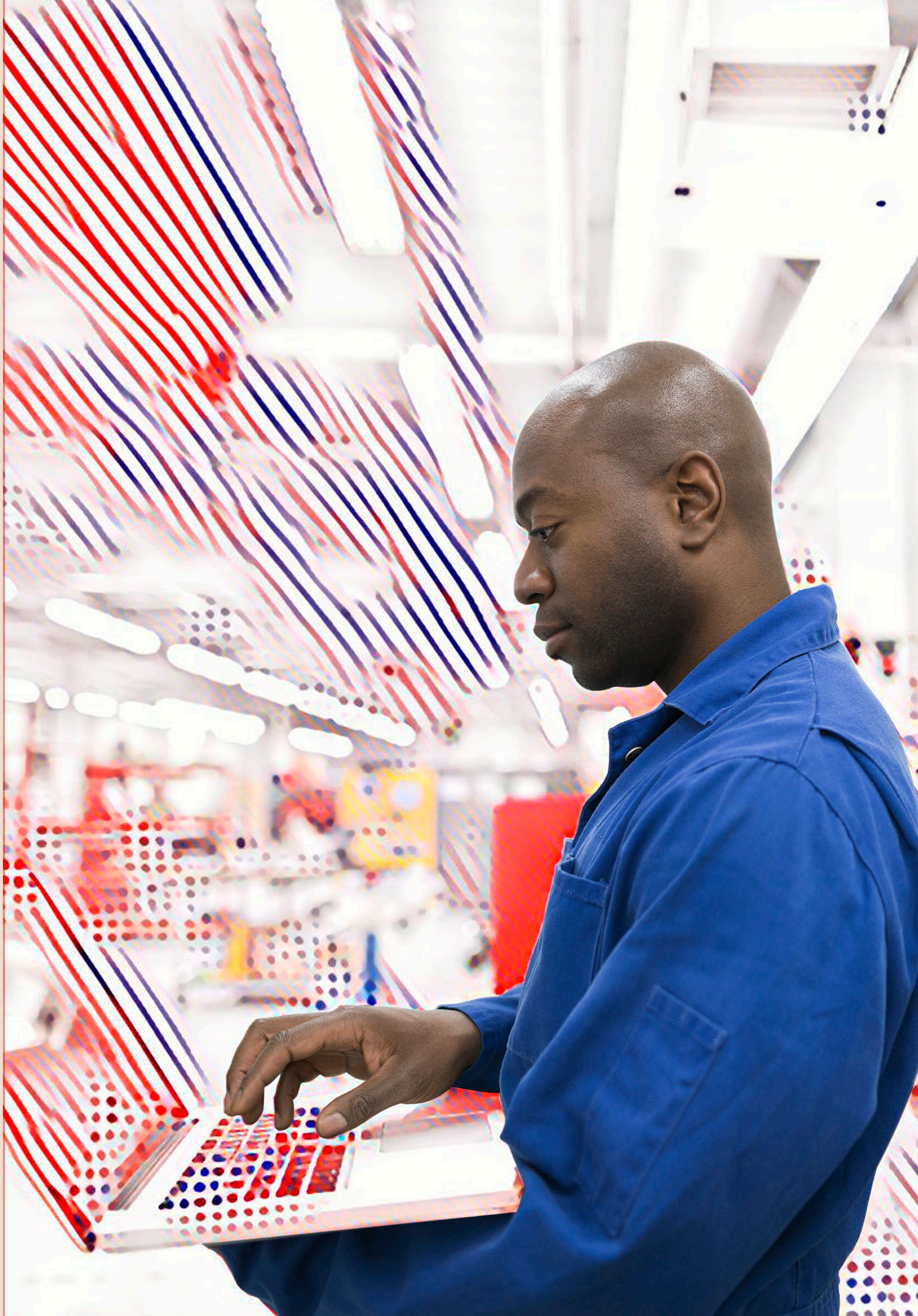
Always Designing for People™



Employer Pay Cards: Staying on the Right Side of Compliance

A Guide to Federal and State Employer Pay Card Compliance Requirements

Contents

Employer Pay Cards: Staying on the Right Side of Compliance

A Guide to Federal and State Employer Pay Card Compliance Requirements

An explosion of new payment methods introduced over the past decade has reshaped how consumers pay for goods and services, and how they manage their spending and finances. Those consumer trends are creating new challenges and opportunities for employers when it comes to how they pay their employees—particularly with so many alternatives to traditional banking services.

This guide is focused on helping employers to better understand the opportunities presented by pay cards, and to clarify some of compliance (bank, state and federal) challenges that may otherwise stand between them and an alternative method of pay that presents tremendous benefits to employer and employee, alike.

The Future of Pay: Why Now is the Right Time for Pay Cards

A general trend away from traditional banks, checking accounts, debit cards and cash/paper check purchases, especially among next generation consumers, has led employers to consider new alternative methods of payment for their workers, including pay cards that don't require employees to maintain a traditional bank account.

Consider the following statistics:

- 13 million Americans without bank accounts rely on check cashing services[1]
- 19% of U.S. households were underbanked in 2017–24.2 million[2]
- 47 percent of Gen Z workers and 31 percent of Millennials said they would turn down a job if they couldn't choose their method of payment[3]

Pay cards are a widely-available alternative to company-issued paper paychecks or direct deposits, that address the needs for every employee—even those who do not have bank accounts. Pay cards can work just like a bank debit card for making payments and purchases—often without the service fees associated with traditional banking.

From an operational perspective, paying employees via pay card can be as simple as issuing a direct deposit, allowing employers to deliver digital payment in a way that helps reduce the cost and burden of issuing paper checks.

Employees can benefit from more flexible payment and financial management tools associated with their pay card. This includes both card and digital wallet-based purchasing, and online or app-based account, budget and spending management.

Considering the benefits to employers and employees, the biggest hurdle to adoption hasn't been cost or convenience. The number one issue employers are concerned about when adopting pay cards with confidence, is compliance with banking, federal government and state government requirements.

The number one issue employers are concerned about when adopting pay cards with confidence, is **compliance.**

The Pay Card Regulation Landscape: A Guided Tour

Pay cards generally are subject to three separate regulatory schemes. First, the banking laws regulate the relationship between financial institutions and their customers. In the pay card context, the banking laws ensure, among other things, that employee cardholders have access to information about their accounts, are protected in the event of unauthorized use or bank insolvency, and enjoy confidentiality of their personal financial information.

Second, federal wage and hour laws regulate the employment relationship and ensure, among other things, that employees are paid their full wages in a timely manner.

Third, separate state regulations generally govern permissible methods of wage payment, including pay cards. With each state issuing their own regulations, it becomes easy to see how a technically simple solution for employee pay gets complicated with regard to compliance.

Banking Regulation

The following section highlights some of the regulations and requirements related to banking that impact employer pay card compliance.

Federal Deposit Insurance Company (FDIC)

The Federal Deposit Insurance Company (FDIC) is an independent federal agency that insures deposits in U.S. banks in the event of bank failures. It was created in 1933 in the wake of the Great Depression to maintain stability in the financial system. As of 2018, the FDIC insures deposits up to $250,000 per depositor, as long as the institution is a member firm.

The funds in a pay card account are eligible for FDIC insurance if the account is held at an insured bank. The FDIC has the name of a particular employee-cardholder, it will recognize the employee to be the owner of the account[4]. This issue is important because, in the event of a bank failure, the FDIC must be able to identify the owner of the deposit in order to ascertain the beneficiary of the insurance payout. Most pay card accounts are pooled accounts with separate subaccounts for each employee. When this is the case, the FDIC will apply its pass-through insurance rules to identify the owner of the deposit.

Under these rules, an individual cardholder will be recognized as the owner of the deposit if three conditions are satisfied. First, the account records of the depository institution must disclose the existence of the agency or custodial relationship. Second, the records of the insured depository institution, custodian or other party must disclose the identities of the cardholders who actually own the deposits and the amount owned by each cardholder. Finally, the funds in the account must actually be owned by the individual cardholders under an agreement among the parties or pursuant to applicable law.

Other Federal Banking Law Provisions

A number of other federal laws/regulations apply to or impact the use of pay card accounts. For example, the 1999 Gramm-Leach-Bliley Act and Regulation P address the use of nonpublic personal information by financial institutions[5]. In addition, the Bank Secrecy Act regulations require financial institutions, including those that issue pay cards, to establish procedures for verifying the identity of their customers[6].

Finally, the Consumer Financial Protection Bureau (CFPB) has stated that direct deposit to a pay card is an important wage payment option of which employees should be advised[7].

Federal Pay Card Regulation

The following section highlights some of the federal laws and regulations that impact employer pay card compliance.

Fair Labor Standards Act

The Fair Labor Standards Act (FLSA) was originally drafted in 1932, but did not pass into law until it was re-drafted and passed in 1938, as part of a package of post-Depression era New Deal reforms, including protection for children from doing dangerous labor, in addition to minimum wage and overtime rules.

President Franklin Roosevelt called the FLSA one of the most important pieces of legislature outside of the Social Security Act of 1935.

Federal wage and hour law generally does not regulate permissible methods of wage payment. The FLSA focuses primarily on the payment of minimum wage and overtime compensation, recordkeeping, and child labor standards[8]. Fees incurred to access wages from a pay card account could violate the FLSA, if they deny employees the ability to receive minimum wage and overtime compensation.

The Electronic Fund Transfer Act and Regulation E

Federal law expressly regulates pay card accounts and imposes certain requirements on both the financial institution that holds the account and employers who offer the pay cards. These provisions are found primarily in the Electronic Fund Transfer Act (EFTA) and its implementing regulation, Regulation E[9].

The EFTA and Regulation E establish the rights, financial liabilities, and obligations of consumers and other participants in electronic fund transfer (EFT) activities. Pay cards have been covered by Regulation E since 2007. In October 2016, the Consumer Financial Protection Bureau (CFPB) issued a final rule (Prepaid Rule) increasing the consumer protections on covered accounts, including pay card accounts, and extending the provisions of Regulation E to a broad range of prepaid products.

Importantly, Regulation E's compulsory use provision prohibits financial institutions and "other persons" from requiring an employee to receive EFTs of wages to an account at a particular financial institution[10]. The CFPB interprets this provision as prohibiting employers from requiring that their employees receive their wages to a pay card account[11].

The CFPB has made clear, however, that the compulsory use provision does not prohibit an employer from offering its employees a choice between a pay card and another method of wage payment. In a 2013 bulletin, the CFPB emphasized that "permissible alternative wage payment method(s) are governed by state law." Thus, while Regulation E would allow employers to offer employees the choice for direct deposit to an account of the employee's choosing or a pay card, state law determines whether a paper paycheck option must also be offered.

The EFTA and Regulation E **establish the rights, financial liabilities, and obligations** of consumers and other participants in electronic fund transfer (EFT) activities. Pay cards have been covered by Regulation E since 2007.

Federal Pay Card Regulation

Regulation E also includes a variety of disclosure requirements. For example, Regulation E requires financial institutions to disclose to consumers all of the terms, conditions, and fees associated with a covered account[12]. Financial institutions are required to provide consumers with additional information before they acquire a prepaid account, including a pay card account[13]. The pre-acquisition disclosures include:

1. A short form disclosure setting forth certain key fees and other information regarding the prepaid card account.
2. A long form disclosure setting forth information about all fees that may be imposed in connection with the prepaid card account and certain other key information (e.g., FDIC insurance, the financial institution's contact information, and how to submit complaints to the CFPB).

The financial institution must disclose its name, the name of the card program, and any fees for purchasing and/or activating the card account (note, pay card programs do not charge fees for obtaining the card or activating the account).

In addition, the financial institution must provide 21 days advance written notice of certain changes in the terms and conditions of the account.

Finally, the card itself must include the name of the financial institution as well as a website and phone number that the consumer may use to contact the financial institution regarding the account.

In addition to the compulsory use provision and the above disclosure requirements, Regulation E requires card issuers to provide employees with periodic activity statements or an alternative to periodic statements.

If an alternative is used, the issuer must do all of the following: (1) make balance information available to employees through a readily available telephone line; (2) make an electronic history available showing the employee's account transactions for a period of at least 12 months; and (3) provide promptly upon an employee's request a written history of the employee's account transactions covering a period of at least 24 months prior to the request. Regulation E also limits cardholder liability when a lost or stolen card is used fraudulently and requires financial institutions to make dispute resolution procedures available to cardholders.

The CFPB's Prepaid Rule also revises another federal rule, Regulation Z, to significantly limit the ability of financial institutions to offer overdraft and credit features on prepaid card accounts. Most pay card programs, however, do not allow for overdrafts or offer overdraft protection.

Regulation E requires financial institutions to disclose to consumers all of the **terms, conditions, and fees associated with a covered account**. Financial institutions are required to provide consumers with additional information before they acquire a prepaid account.

State Pay Card Regulation

Over half the states in the U.S. have regulations regarding employer use of pay cards. In the absence of a state regulation specific to pay cards, it is best practice to comply with state regulations that apply to direct deposit, as the transfer of funds to the payroll account can be interpreted as the same, or similar type of transaction.

States with their own pay card legislation vary in how they treat pay cards and the conditions they impose when pay cards are offered.

One KEY reminder as it applies to compliance requirements, from the perspective of ADP, is that where there is a conflict between state and federal compliance requirements, particularly with regard to employee consent, the best practice is to adhere to the more strict of the two.

State Pay Card Compliance Examples

- GA 2019: 30 days notice to existing employees; removed check requirement
- TX 2019: requirements around terms/fees disclosures
- PA 2017: paycard is permitted if employer does not mandate paycard, disclosure/terms/fee requirements, no fees for using card, free method of checking balance
- NY 2016: requires advance written consent, consent is not valid for 7 days, requires disclosures to be in 12 pt font (other states say 12, some say 10), 30 days notice for any change in fees/terms/ conditions, ATM network for free, free to the penny withdraw, free statements, employer cannot receive any financial remuneration from issuer/ sponsor/program manager, regulates fees (most for free), etc.

Choice and Consent

Employees must be given some choice as to how they receive their wages. Federal EFTA and Regulation E requirements (highlighted earlier) prohibit employers from requiring that employees receive wages using a pay card. Employees who are offered a pay card must also be given at least one other payment option. Permissible alternative wage payment methods are governed by state law and typically include cash, check, and/or direct deposit.

About half of states allow employers to offer their employees the choice between direct deposit and a pay card without also offering a paper paycheck option. In the remaining states, a paper paycheck option is required and often must be the default method of payment.

Some states require employers to offer both direct deposit and a paper paycheck to employees who are offered pay cards.

States that currently allow employers to require direct deposit also allow employers to give their employees the choice between direct deposit to an account of their choosing, or direct deposit to a pay card account.

State choice and consent provisions should make clear what will happen when an employee fails to make an election. Specifically, employers should be able to credit wages to a pay card account when the employee has been offered the choice but fails to provide the information necessary for direct deposit (e.g., the routing and account number).

States mandating check payment as an option:

- Arkansas
- California
- Connecticut
- Hawaii
- Idaho
- Illinois
- Minnesota
- Montana
- New Hampshire
- New York
- Oregon

State Pay Card Regulation

Full and Free Access to Wages

Both federal and state wage and hour laws require that employees be paid their wages on the established payday. If an employee elects to receive a pay card, his or her full net wages must be deposited into the pay card account on or before pay day and must be available to the employee for use or withdrawal on that day. The full and free access to wages requirement is interpreted in most states to mean that employees must be able to make at least one withdrawal of up to their full net wages from the pay card account each pay period without fees.

In other words, employees must be able to "cash out" their net wages like they would a paper paycheck on or after payday. Some states vary from this general rule, however, a few states like Hawaii, Illinois, New York and others require that free withdrawal each pay period provides for access to the full pay card account balance, not just the employee's net pay for the pay period.

Disclosure Requirements

In addition to the disclosures required under the federal banking laws, the state wage and hour laws often require employers to provide their employees with information about their pay card program. Some states require employers to notify employees about all of their wage payment options and to explain to employees how they can access their wages, check their account balances, or receive transaction histories without cost.

Fee Prohibitions

Fees that deny employees the opportunity to access their full net wages each pay period generally are viewed as violating the full and free access to wages requirement. For this reason, many states prohibit fees for the initial pay card, one replacement card a year upon request, participation in the program, loading wages into the card account, and monthly maintenance of an active account.

Many states prohibit fees for the initial pay card, one replacement card a year upon request, participation in the program, loading wages into the card account, and monthly maintenance of an active account.

State Pay Card Regulation

Access to Account Information

Many states require that employees be provided access to their account balance online and/or over the telephone without cost. A few states have attempted to regulate the provision of transaction histories to pay card holders. The obligation to provide account transaction histories necessarily falls with the financial institution or program administrator, not the employer. Access to transaction histories is similarly required under federal banking law and under Regulation E[14].

Other considerations: Termination Pay

Termination pay is a sensitive issue regardless of the form of pay to the soon-to-be-former employee. The key issue here as it relates to pay cards is the timing and method of pay.

In some states, a printed check must be presented to the employee upon termination. So, even if your employee has consented to be paid via pay card and your goal is to deliver a 100% digital solution, this is the kind of exception you need to be prepared to address.

Forty-eight states have regulated in some fashion how and when termination pay (if employer is discharging employee) must be paid. How termination pay should be handled is written more than a dozen different ways among those states.

Eight states mandate that involuntarily terminated employees must be paid at the time of discharge: California, Colorado, Hawaii, Massachusetts, Minnesota, Missouri, Montana and Nevada.

Three require that the terminated employee must be paid the next business day or within 24 hours: Connecticut, Washington, DC and Oregon.

Fee Prohibitions Example: New York

An employer or agent shall not charge, directly or indirectly, an employee a fee for any of the items listed in this subsection. Inclusion in this subsection does not impose any separate or independent obligation to provide services, nor does it relieve an employer or agent from compliance with this Part or any Federal or State law or regulations:

(1) Application, initiation, loading, participation or other action necessary to receive wages or to hold the payroll debit card;

(2) Point of sale transactions;

(3) Overdraft, shortage, or low balance status;

(4) Account inactivity;

(5) Maintenance;

(6) Telephone or online customer service;

(7) Accessing balance or other account information online, by Interactive Voice Response through any other automated system offered in conjunction with the payroll debit card, or at any ATM in network made available to the employee;

(8) Providing the employee with written statements, transaction histories or the issuer's policies;

(9) Replacing the payroll debit card at reasonable intervals;

(10) Closing an account or issuing payment of the remaining balance by check or other means; or

(11) Declined transactions at an Automated Teller Machine that does not provide free balance inquiries.

(12) Any fee not explicitly identified by type and by dollar amount in the contract between the employer and the issuer or in the terms and conditions of the payroll debit card provided to the employee.

Conclusions and Key Takeaways

As we've explored from the perspective of employers, pay cards present a timely opportunity to leverage a new pay method in a way that addresses employee priorities while helping cut costs. At the same time, this opportunity comes with some caveats with regard to compliance.

BUT, for experienced payroll providers, compliance requirements as they relate to payroll in general, and pay cards in particular, are not only second nature—they're at the heart of their business.

Finding an experienced pay card service provider can help you clean up the clutter, navigate complexities and offer your employees the flexible pay methods they want, while mitigating risk.

- Pay cards represent a huge opportunity for employers to deliver greater value and convenience to employees who desire more convenience and flexibility
- Pay card compliance is complex, with a variety of overlapping banking, federal and state compliance requirements
- Prioritize expertise and compliance resources when evaluating pay card providers to mitigate risk and maximize returns

For experienced payroll providers, **compliance requirements** as they relate to payroll in general, and pay cards in particular, are **not only second nature—they're at the heart of their business.**

How ADP can help

Pay cards present a great opportunity for companies to attract top talent by leveraging flexible, convenient payment options as an added incentive, while lowering the operating costs and risks associated with traditional payroll methods. If the biggest hurdle to putting pay cards to work for your company is the systems and processes you rely on to monitor and maintain compliance, ADP can help.

The ADP Wisely® Pay Card: Meet the Pay Needs of Today's Workforce

Wisely Pay is a modern pay card solution that helps you move to paperless pay while also providing employees with a flexible pay card or reloadable account.

Wisely addresses employer and employee pay needs with a solution that is:

- Enabled to be compliant in all 50-states
- Easy for employees to sign up for
- Saves administrative time and money
- Compatible with existing payroll systems

Always Designing for People™

To learn more about Wisely, visit www.adp.com

DISCLAIMER: The information provided in this document is for informational purposes only and not for the purpose of providing legal, accounting, or tax advice. The information and services ADP provides should not be deemed a substitute for the advice of any such professional. Such information is by nature subject to revision and may not be the most current information available.

[1] Chicago Sun Times, "End cycle of debt by paying workers in real time," 10/22/2018

[2] FDIC, National Survey of Unbanked and Underbanked Households, 2017, https://www.fdic.gov/householdsurvey

[3] Paycards: Generational trends shaping the future of worker pay, ADP Research Institute 2019

[4] FDIC General Counsel Opinion No. 8, 73 Fed. Reg. 67155 (Nov. 13, 2008).

[5] 15 U.S.C. § 6801 et. seq.; 12 C.F.R. Part 1016.

[6] 31 C.F.R. § 1020.220.

[7] Prepaid Accounts under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), 81 Fed. Reg. 84060-84061 (November 22, 2016).

[8] 29 U.S.C. § 201 et seq

[9] 15 U.S.C. § 1693 et seq; 12 C.F.R. Part 1005.

[10] 12 C.F.R. § 1005.10(e)(2)

[11] CFPB Bulletin No. 2013-10 (September 12, 2013)

[12] 12 C.F.R. § 1005.7(b)

[13] 12 C.F.R. § 1005.18(b)(1)(i) (effective April 1, 2019). In the Pay Card context, a consumer acquires an account when he or she chooses to be paid via a Pay Card account.

[14] 12 C.F.R. § 1005.18(b) (effective April 1, 2019).