Office of Thrift Supervision
Department of the Treasury
Chief Counsel
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

August 29, 1996

[redacted]

Re: Authority of Federal Savings Associations to Market and Sell Prepaid Telephone Cards

Dear [redacted]

This responds to your letter submitted on behalf of [redacted] (the "Association"), inquiring whether the Association may market and sell prepaid telephone cards as agent for [redacted] (the "Phone Company").

In brief, we conclude that, pursuant to the incidental powers doctrine, the Association may market and sell prepaid telephone cards as agent for the Phone Company, in the manner described below.

I. Background

The Association, a federally chartered savings bank, proposes to enter into an agreement with the Phone Company, a company that purchases telephone services from long distance carriers at bulk rates and resells these services to the general public. Under the agreement, the Phone Company would provide prepaid telephone cards to the Association, and the Association, as agent for the Phone Company, would market and sell the cards to its customers at set prices. The Association's marketing activities would include mailing notices to its customers informing them of the availability of the telephone cards, and posting advertisements at the Association's retail offices.

The Association would remit all card sale proceeds to the Phone Company, less a commission equal to a percentage of the sales proceeds. The term of the proposed agreement is one year, but would be renewable by the Association and the Phone Company on a year-to-year basis.

The Phone Company's cards provide the cardholder with access to a specified number of long distance "units." Each unit represents one minute of long distance calling time within the United States. International calls are available at a higher unit charge per minute.

Functionally, the Phone Company's prepaid telephone card is a type of remote access card. Under the Phone Company's system, cardholders may access long distance telephone services through any touch tone phone by dialing the Phone Company's toll-free telephone number. The toll-free number connects the cardholder with the Phone Company's computer system which prompts the cardholder to enter the unique account number preprinted on the card and the desired long distance telephone number. The computer matches the account number with stored data, including the unit balance attributable to the card, places the call on behalf of the cardholder, and deducts an appropriate number of units from the balance.[1]

The Association has requested confirmation that it may market and sell prepaid telephone cards on the terms described above.

II. Discussion

While the Home Owners' Loan Act ("HOLA") does not expressly authorize federal savings associations to market and sell prepaid telephone cards, the OTS and the FHLBB have long recognized that federal savings associations possess "incidental" powers, i.e., powers that are incident to the express powers of federal savings associations, as set forth in the HOLA. The OTS employs a four-part test to identify activities that fall within the incidental powers of federal savings associations.[2] Our analysis below is based on this four-part test.

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[1] The Phone Company's card is not a stored value card -- also known as a "smart" card. Under this alternate technology, the balance of cash or units available to a cardholder would be maintained on a microprocessor chip embedded in the plastic card.

[2] OTS Op. Chief Counsel (Mar. 25, 1994).

A. Does the activity relate to the financial intermediary role that all federal savings associations were intended to play?

The courts have recognized that, when reduced to their essence, depository institutions serve as financial intermediaries, facilitating the flow of money and credit among different parts of the economy. As the Supreme Court has noted, "[t]he very object of banking is to aid the operation of the laws of commerce by serving as a channel for carrying money from place to place."[3] Like banks, thrifts are obviously intended to serve as financial intermediaries, especially at the consumer level.[4]

The telephone card, in substance, represents the cardholder's prepayment for telephone services. The Association, by selling the Phone Company's card, will assist in the performance of a bill payment function by transferring funds from the consumer to the service provider. Such transfers of funds are critical to the unimpaired flow of commerce and a fundamental part of the business of banking.[5]

Such transfers are to be distinguished from direct sales of goods and services. Here, the thrift is not selling a product itself (i.e., telephone service), but rather a prepaid account that may be drawn upon by the customer to later acquire a product. The customer must engage in a second transaction, directly contacting the Phone Company, to obtain the actual product. Furthermore, if the customer is dissatisfied with the quality of the service provided, he or she must contact the Phone Company, not the Association. Thus, rather than providing telephone service, the thrift's role is simply to transmit funds from the customer to the provider of the product and to deliver the prepaid account to the customer.

Accordingly, we conclude that the sale of the Phone Company's cards is intimately related to the financial intermediary role that federal savings associations are intended to play in the economy.

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[3] Auten v. United States National Bank, 174 U.S. 125, 143 (1899).

[4] OTS Op. Chief Counsel (Mar. 25, 1994).

[5] See OCC Interp. Letter No. 718 (Mar. 14, 1996).

B. Is the activity consistent with the purpose and function Congress envisioned for federal savings associations, as manifest in the legislative history of the HOLA?

As explained in detail in various OTS opinions,[6] Congress has amended the HOLA over the past two decades, inter alia, to expand and modernize the role of federal savings associations, while strengthening the safety and soundness framework in which they operate. The legislative history of these amendments indicates that Congress intended to give federal savings associations the "flexibility . . . to improve the range of services . . . [provided] to their customers,"[7] and to "enhance the ability of thrifts to offer complete financial services to the consumer."[8] Congress' objective was to enable federal savings associations to meet the needs of ordinary consumers "across the board" in "one-stop family financial centers."[9]

The ability to sell telephone cards will further this objective. The prepaid cards will provide consumers with a new way to pay for telephone services, and will supplement other bill payment options already available from savings associations, including home bill payer services.[10] Providing consumers with additional payment options, by definition, increases convenience. Instead of having to go to the office of the Phone Company to obtain the card, or ordering the card by from Phone Company and awaiting delivery, consumers will be able to purchase their cards at any of the Association's retail offices at the same time they conduct their other financial business. By serving as an intermediary that transmits funds between the consumer and the Phone Company, the Association will provide a valuable financial service to its customers.

Therefore, we conclude that the sale of these cards is consistent with the role Congress envisioned for savings associations as full service financial centers.

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6 E.g., OTS Op. Chief Counsel (Mar. 25, 1994).

7 H. Conf. Rep. No. 899, 97th Cong., 2nd Sess. 87 (1982).

8 S. Rep. No. 368, 96th Cong. 1st Sess. 13 (1979).

9 Id.

10 12 C.F.R. § 545.142 (home banking services).

C. Is the activity similar to or does it facilitate the conduct of an activity expressly authorized for federal savings associations?

Another test that the courts often employ when considering whether an activity falls within the incidental powers of a depository institution is whether the activity is similar to or facilitates the conduct of other expressly authorized powers.

As noted above, prepaid telephone cards will offer Association customer's a new way to pay their bills. Savings associations have traditionally facilitated customer bill payment activities through various means including the provision of checking and home bill payer services. The sale of prepaid telephone cards is also similar to the sale of traveler's checks,[11] and certain credit card activities.[12]

Traveler's checks, for example, are typically sold by savings associations on behalf of third party issuers. With traveler's checks, as with the telephone cards, the savings association receives funds from the customer, delivers evidence of prepayment to the customer, and transmits the customer's funds to the issuer. The savings association typically will receive a fee from the issuer for performing this financial intermediary function. Although traveler's checks can be used to purchase any type of product or service (whereas the telephone cards can only be used to purchase telephone services), this is not a distinction that matters from the perspective of the selling association.[13] From the Association's perspective, the functions performed, the expertise required, and the risks presented in selling telephone cards are the same as in selling traveler's checks.

The services that savings associations provide in connection with credit cards are also quite similar to those proposed for telephone cards. Credit cards are also a means of facilitating consumer purchases from third party merchants. When a purchase is made using a credit card issued by a savings association, the association, directly or through an intermediary institution, transmits payment to the merchant and then collects payment from the consumer. Telephone cards

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[11] Federal savings associations are permitted to market and sell traveler's checks. FHLBB Op. Gen. Counsel (Nov. 24, 1965); FHLBB Op. by Williams (Mar. 16, 1988). See Arnold Tours v. Camp., 472 F.2d 427 (1st Cir. 1972).

[12] Federal savings associations are permitted to issue credit cards, extend credit therewith, and otherwise engage in credit card operations. 12 U.S.C.A. § 1464(b)(4)(West. Supp. 1996).

[13] In this respect, prepaid telephone cards are similar to another prepayment medium available from thrifts, the postage stamp. See OTS Op. Chief Counsel (Mar. 25, 1994).

involve the same essential funds transfer functions, but at less risk to the savings association because the telephone cards are prepaid.[14]

Accordingly, we conclude that the proposed activity is quite similar to powers already expressly authorized for savings associations.

D. Is the activity necessary to enable federal savings associations to remain competitive and relevant in the modern economy, thereby permitting federal savings associations to fulfill the purposes for which they were created?

When assessing whether an activity properly falls within the scope of a depository institution's incidental powers, the courts frequently consider whether institutions of the type in question need to engage in the activity in order to keep pace with changes in the modern economy. When employing this test, the courts often consider whether the activity is one that consumers have come to expect depository institutions to perform as a matter of convenience and/or whether depository institutions need to offer the services in question in order to keep pace with their competitors.

The prepaid telephone card responds to consumer demand for convenient alternative methods of paying for goods and services, and to merchant demand for more convenient methods of revenue collection. Consumers are becoming increasingly accustomed to the convenience of purchasing prepaid telephone cards at locations where they routinely conduct their other financial business. For example, the Office of the Comptroller of the Currency recently issued an interpretive letter permitting national banks to provide telephone cards.[15] Permitting federal savings associations to offer these same services will help them retain their customer base and remain competitive with other financial institutions, including national banks.

As the foregoing analysis indicates, all of the factors commonly considered in the incidental powers analysis support the conclusion that the

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[14] See OCC Interp. Letter No. 718 (Mar. 14, 1996)(comparing the functions of an institution dispensing various types of alternate prepaid media, including prepaid telephone cards, with the services performed by a bank issuing credit cards and providing credit card sales draft clearing services).

[15] Id. (national banks may sell prepaid telephone cards, as well as public transportation tickets, gift certificates and event tickets, from approved customer-bank communication terminal branches).

Association may sell the prepaid telephone cards on behalf of the Phone Company. Accordingly, we conclude that this activity is permissible for federal savings associations under the incidental powers doctrine.

As a final matter, we note that the Association also intends to notify customers in mailings and advertisements in its retail offices that telephone cards are available for purchase. Marketing and advertising are integral and essential components of a federal depository's ability to exercise any authorized power,[16] and are expressly authorized for federal savings associations by the HOLA.[17] Accordingly, we conclude that federal savings associations may also market and advertise the prepaid telephone cards in the manner proposed by the Association.

In reaching the foregoing conclusions, we have relied on the factual representations made in the materials you submitted to us. Our conclusions depend on the accuracy and completeness of those representations. Any material change in facts or circumstances from those described herein could result in a different conclusion.

In you have any questions regarding this matter, please feel free to contact Karen Osterloh, Counsel (Banking and Finance), at (202) 906-6639.

Very truly yours,

Carolyn J. Buck
Chief Counsel

cc: [redacted]

All Regional Directors
All Regional Counsel

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[16] See OTS Op. Chief Counsel (June 21, 1996) citing Franklin Nat'l Bank v. New York, 347 U.S. 373 (1954).

[17] 12 U.S.C.A. § 1468a (West Supp. 1996).