



Direct Response Forum, Inc.

18th Annual Forum

Westin Seattle, WA Sunday August 5th through Tuesday August 7th 2007

Retail Sales under the Electronic Fund Transfer Act/Regulation E

Andrew J. Lorentz, WilmerHale



Outline

- Why do EFTA/Reg E matter?
- Overview of EFTA/Reg E
- Key definitions
- Issues for retailers
 - Billing issues under Reg E
 - Other issues for debit or stored value programs
- Regulatory developments
- Enforcement



Why do EFTA/Reg E matter?

- Central elements in federal consumer protection law governing **DEBITS**
- Civil liability up to lesser of 1% net worth or \$500,000 for class actions
- Criminal liability up to 1 year imprisonment and \$5,000 in fines for “knowing and willful” violations
- EFTA authorizes Federal Trade Commission to use all enforcement powers under FTC Act
 - Investigations culminating in formal orders, informal MOUs
 - Violations of FTC orders carry civil penalties of \$11,000/day
 - Consumer redress also available
 - Injunctions



Why do EFTA/Reg E matter?

- Must also consider:
 - o State and federal Unfair and Deceptive Acts and Practices laws
 - o Federal Trade Commission's trade rules
 - o State and federal rules on information sharing and privacy
 - o Payment association rules and merchant acquiring agreements
 - o National Automated Clearing House Association Rules
 - o State money transmitter, gift card and abandoned property laws
 - o E-SIGN and state Uniform Electronic Transactions Acts



Overview of EFTA/Reg E

- Electronic Fund Transfer Act
 - o Primary objective: protect consumers engaging in electronic fund transfers
 - o Preempts less protective state law
- Reg E implements EFTA
 - o Issued and interpreted by Federal Reserve
 - o Enforced by the Federal Trade Commission for retailers



Overview of EFTA/Reg E

- Reg E found at 12 C.F.R. 205
 - o 18 Sections in regulation plus:
 - o Appendix A – Model Disclosures
 - o Appendix B – Federal Enforcement Agencies
 - o Appendix C – Issuance of Staff Interpretations
 - o Supplement I – Official Staff Interpretations (a.k.a. “Commentary”)



Key definitions

Reg E applies to “any *electronic fund transfer* that authorizes a *financial institution* to debit or credit a consumer’s *account*.” Generally applicable to financial institutions, but certain terms apply to “any person”.

- o *Electronic fund transfer* means “any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing or authorizing a financial institution to debit or credit a consumer’s account.”
- o Includes (among others) point of sale transfers, ATM transfers, direct deposits or withdrawals, telephone transfers, or debit card transfers (whether or not initiated through an electronic terminal).



Key definitions

- o *Financial institution* means " a bank, savings association, credit union, or any other person that directly or indirectly holds an account belonging to a consumer, or that issues an access device and agrees with a consumer to provide electronic fund transfer services."
- o *Account* means " a demand deposit (checking), savings, or other consumer asset account (other than an occasional or incidental credit balance in a credit plan) held directly or indirectly by a financial institution and established primarily for personal, family, or household purposes."



Issues for retailers

For retailers, two major types of issues under Reg E:

- o Provisions of Reg E expressly applicable to “any person”
 - Principal concern for compliance of billing operations
- o Provisions of Reg E applicable to persons holding consumer accounts or issuing access devices
 - Relevant to debit, stored value, or similar programs and should be considered in evaluating partnerships such as private label or co-branded card programs



Billing issues and Reg E

- Preauthorized electronic fund transfers
- Electronic fund transfer using information from a check
- Collection of returned item fees via electronic fund transfer
- Form of disclosures



Preauthorized electronic fund transfers

- *Preauthorized electronic fund transfer* " means an electronic fund transfer authorized in advance to recur at substantially regular intervals."
 - **Signature requirement.** Preauthorized EFTs "from a consumer's account may be authorized *only* by a writing *signed or similarly authenticated* by the consumer."
 - Cannot be met by a payee signing on the consumer's behalf based on oral authorization
 - Writing and signature requirements are satisfied by complying with E-SIGN



Preauthorized electronic fund transfers

- “The authorization process should evidence the consumer’s *identity* and *assent* to the authorization.”
- “An authorization is valid if it is *readily identifiable* as such and the terms . . . are *clear and readily understandable*.”
- EFTA: “[A] copy of such authorization shall be provided to the consumer *when made*.”
 - Reg E: “The person that obtains the authorization shall provide a copy to the consumer.”
 - Commentary: “The person that obtains the authorization must provide a copy . . . to the consumer, either electronically or in paper form.”



Preauthorized electronic fund transfers

- o ***Bona fide error.*** A payee will not violate the written authorization requirement if it fails to obtain written authorization in the mistaken belief that it is processing a credit card, provided the mistake resulted from *bona fide error* and the payee maintains *procedures reasonably adapted* to avoid any such error.
 - “*Procedures reasonably adapted . . .* depend upon the circumstances. Generally, requesting the consumer to specify whether the card . . . is a debit (or check) card or a credit card is a reasonable procedure.”



Preauthorized electronic fund transfers

- Fed preamble to rule change: “[G]iven the growth of debit card usage, the Board believes that *reasonable procedures should include interaction with the consumer specifically designed to elicit information about whether a debit card is involved.*”
- Payees may rely on the consumer’s statement without seeking further information about the type of card.
- If the payee later learns the card is a debit card, must obtain written authorization or cease debiting.



Preauthorized electronic fund transfers

- **Notice of varying amount.** When a preauthorized EFT will vary from the *previous transfer* under the same authorization or from the *preauthorized amount*, must send the consumer *written notice of the amount and date* of the transfer at least *10 days before the date* of transfer.
 - Payee must inform consumer of right to receive notice of all varying transfers, but may give the option of receiving notice only when a transfer falls outside a specified range or differs from the most recent transfer by more than an agreed amount.
 - Range must be “an acceptable range that could be anticipated by the consumer.” Example provided is for payment of a gas bill, for which an “appropriate range might be based on the highest bill in winter and the lowest bill in summer.”



Electronic fund transfer using information from a check

- Applies where a check, draft or similar paper instrument is used as source of information for initiating a one-time EFT.
- Requires notice to the consumer by the “person initiating [the] . . . transfer” that the “transaction *will* or *may* be processed as an EFT” and authorization by the consumer of the transfer.
- Consumer is deemed to authorize the transfer “when the consumer receives notice and goes forward with the underlying transaction.”



Electronic fund transfer using information from a check

- For POS transfers, notice must be posted in a “prominent and conspicuous location” and a copy or substantially similar notice must be provided to the consumer at the time of the transaction.
- Further notices required to consumers at same time as above notices (but only effective through Dec. 31, 2009):
 - Notice that funds may be debited from the consumer’s account as soon as the same day payment is received



Electronic fund transfer using information from a check

- o As applicable, notice that the consumer's check will not be returned by the financial institution holding the consumer's account.
- o For POS transfers, notice may be posted in a "prominent and conspicuous location" and need not be included on the copy of other notices provided to the consumer.



Collection of returned item fees via electronic fund transfer

- Must obtain consumer authorization to use EFT to collect a fee for an EFT or a check that is unpaid, including due to insufficient or uncollected funds in the consumer's account.
- Consumer is deemed to authorize the transfer "if the person collecting the fee provides notice . . . and the consumer goes forward with the underlying transaction."



Collection of returned item fees via electronic fund transfer

- Notice must state that the fee will be collected by means of an EFT and state the amount of the fee; if the fee varies, must provide an explanation of how the fee will be determined.
- For POS transactions, notice must be posted in a “prominent and conspicuous location” and a copy or substantially similar notice must be provided to the consumer at the time of the transaction or mailed as soon as “reasonably practicable” after the EFT is initiated.



Collection of returned item fees via electronic fund transfer

- Notice must provide amount of the fee; if the fee varies, must provide an explanation of how the fee will be determined and must provide amount if it can be established before providing or mailing the notice (Note: compliance with this provision is only required after Dec. 31, 2007)



Form of disclosures

- “ Disclosures required under [Reg E] shall be clear and readily understandable, in writing, and in a form the consumer may keep.”
- “[T]here are no particular rules govern[ing] type size, number of pages, or the relative conspicuousness of various terms.”



Other issues for debit or stored value programs

- General provisions of Reg E apply both to traditional financial institutions as well as to:
 - Persons who issue *access devices*, defined as “a card, code, or other means of access to a consumer’s account, or any combination thereof, that may be used by the consumer to initiate electronic fund transfers.”
 - Persons who provide EFT service to a consumer without holding the consumer’s account.
- Reg E governs the rights, liabilities and responsibilities of participants in EFT systems generally, and duties may be allocated contractually among different parties.



Other issues for debit or stored value programs

- Examples of key provisions:
 - Prohibition against issuing unsolicited access devices unless unvalidated
 - Liability limitations: three tiers of consumer liability for unauthorized transfers:
 - Liability capped at \$50 if the consumer notifies the financial institution within two business days of loss or theft
 - Liability capped at \$500 if notice provided later, but --
 - Unlimited liability for subsequent unauthorized transfers if fail to notify within 60 days of statement



Other issues for debit or stored value programs

- o Initial disclosures of consumer rights
- o Change in terms and error resolution notices
- o Periodic statements (monthly or quarterly)
- o Investigation, provisional crediting, and error resolution procedures (“error” includes unauthorized transfers)
- o Special provisions for payroll accounts
- o May not condition extension of credit on repayment by preauthorized EFT



Regulatory developments

- No receipt required at electronic terminal for transfers of \$15 or less (effective Aug. 6, 2007).
- Proposal to delete specific terms regarding electronic communications with consumers (comment period ended June 28, 2007).



Enforcement

- Remote Response Corp. (2006)
 - Advance-fee MasterCard
- Berkeley Premium (2006)
 - Dietary supplements
- Mantra Films, Inc. (2004)
 - Seller of "Girls Gone Wild" DVDs/videos
- AOL, CompuServe, Prodigy (1998)



Enforcement

Characteristics:

- Usually coupled with other counts under FTC Act or other consumer protection laws
- FTC orders feature lengthy supervision periods, detailed record keeping and reporting
- Frequently challenged practices:
 - o Unclear or insufficient disclosure of offer terms
 - o Failure to obtain written authorization for recurring transfers or debiting before obtained



Enforcement

- o Negative options and a failure to obtain affirmative authorization or clearly disclose need to cancel
- o Difficult cancellation or refund process
- o Obtaining assent to something other than recurring transfer
- o Ambiguous consumer responses taken as authorization (“uh huh”)
- o Manipulated or falsified recordings
- o Confusing requests to punch numbers on a keypad as authorization



Questions?

WilmerHale
Andrew J. Lorentz
Washington, D.C.
202-663-6070

Andrew.Lorentz@wilmerhale.com

Major practice areas of WilmerHale's financial institutions department include retail financial services, bank regulatory, litigation, enforcement, privacy and information security, anti-money laundering, and transactions.