UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Secretary

February 4, 2005

Jennifer L. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, N.W.
Washington, D.C. 20551

Re: Docket No. R-1210

Dear Ms. Johnson:

The Federal Trade Commission ("Commission" or "FTC") appreciates the opportunity to comment on amendments proposed by the Federal Reserve Board ("Board") to Regulation E, which implements the Electronic Fund Transfer Act ("EFTA"), and its Official Staff Commentary ("Commentary").[1]

The FTC has wide-ranging responsibilities concerning consumer financial issues for most nonbank segments of the economy that may be affected by this proposal, including diverse retail sellers, creditors, and other payees. The FTC enforces numerous federal financial requirements concerning consumer payments, including the EFTA, the Truth in Lending Act ("TILA") (including the Fair Credit Billing Act, the Fair Credit and Charge Card Disclosure Act, and the Consumer Leasing Act), and Section 5 of the Federal Trade Commission Act ("FTC Act"), which prohibits unfair and deceptive acts and practices.[2] The FTC also develops consumer and business educational publications on these topics; works with other federal and state enforcement entities; and regularly responds to inquiries about consumer financial laws from consumers, industry officials, other law enforcers, and the media.[3]

The Board has requested comment on various proposed revisions to Regulation E and the Commentary. This request is timely because consumers are increasingly using electronic

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[1] The EFTA is at 15 U.S.C. § 1693 et seq.; Regulation E is at 12 C.F.R. § 205; the Commentary is at 12 C.F.R. § 205, Supp. 1. The EFTA provides a framework for the rights, liabilities, and responsibilities of participants in electronic fund transfer systems. See "Findings and Purpose" of the EFTA. 15 U.S.C. § 1693.

[2] The TILA is at 15 U.S.C. § 1601 et seq.; the FTC Act is at 15 U.S.C. § 41 et seq.

[3] Information regarding these activities is available at: http://www.ftc.gov.

payment systems to pay for goods and services. These new payment systems can offer efficiencies for consumers and industry, enhance consumer choice in the marketplace, and benefit consumers and the economy. Because many consumers are not familiar with these systems, however, and because of the potential for fraudulent activity involving electronic payment systems, clear disclosures about these payment systems and appropriate consumer protections are important.

Based upon the Commission's experience in enforcing and administering consumer protection laws, particularly federal laws concerning consumer payments, these comments focus on three areas of the Board's proposals: 1) electronic check conversion; 2) recurrent debits or preauthorized transfers; and 3) investigations involving disputed charges to a consumer's account, or error resolution.

I. ELECTRONIC CHECK CONVERSION

In electronic check conversion ("ECK") transactions,[4] a consumer provides a check to a merchant or other payee to allow the payee to use the routing, account, and serial numbers on the check to initiate a one-time electronic fund transfer ("EFT") from the consumer's account.[5] ECK transactions also occur when a consumer mails a check for a payment that is converted to a one-time EFT. ECK transactions are covered by the EFTA and Regulation E if the consumer authorizes the transaction as a one-time EFT.[6] According to the Commentary, a consumer authorizes an EFT if the consumer receives notice that the transaction will be processed as an EFT and the consumer completes the transaction.[7]

A. COVERAGE OF MERCHANTS AND OTHER PAYEES

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[4] ECK reportedly has skyrocketed in recent years. Between 2000 and 2003, the number of ECK transactions rose from 32 million to 204 million annually. There were 306 million ECK transactions in the third quarter of 2004 alone. See What's Next for Electronic Checks, American Banker (Nov. 1, 2004), at 38, and http://www.nacha.org.

[5] For example, a consumer may present a check to a retail merchant as payment for goods or services. At the counter, the merchant scans the source information from the bottom of the check into the merchant's system and processes the information electronically for quick payment. The merchant then hands the paper check back to the consumer.

[6] The EFTA and Regulation E govern these transactions because they are not deemed to be transfers originated by check. This is the case whether the check used in the ECK transaction is blank, partially completed, or fully completed and signed; whether the check is presented to a merchant at point-of purchase or is mailed to a payee and later converted to an EFT; or whether the check is retained by the consumer, the merchant or other payee, or the payee's financial institution. 59 Fed. Reg. 56,000 (Sept. 17, 2004).

[7] See 69 Fed. Reg. 55,996. Section 205.3(b)-3 of the Commentary, 12 C.F.R. § 205.3(b)-3, Supp. 1.

Currently, the Commentary does not specify which entities are responsible for obtaining the requisite consumer authorization.[8] Accordingly, the Board has proposed amending Regulation E to specifically require merchants and other payees that use ECK services to obtain consumers' authorization for ECK transactions.[9] The FTC would be the agency primarily responsible for enforcing this proposed amendment to Regulation E, based on its jurisdiction over merchants and other nonbank entities.[10]

The Commission supports the Board's proposed amendment. Diverse in-store sellers and payees (including retailers, dental and medical providers, and others) and entities receiving bill payments (such as utility companies, creditors, and others) use ECK services for consumer transactions. These transactions differ in key respects from familiar checking transactions, including the fact that the transactions typically are processed, and the funds debited from the consumer's account, more rapidly than paper checks. Therefore, it is important that Regulation E clearly designate the entities responsible for obtaining consumers' authorization for these transactions.[11] In addition, without specific coverage under Regulation E of the entities responsible for providing this information to consumers, enforcement of the authorization and notice requirements is difficult.[12]

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[8] Section 205.3(b)-1.v. and -3 of the Commentary. 12 C.F.R. § 205.3(b)-1.v. and -3, Supp.1.

[9] 69 Fed. Reg. at 55,997; proposed Sections 205.3(a) and (b)(2) of Regulation E, and proposed Section 205.3(b)(2)-1 of the Commentary. See 69 Fed. Reg. at 56,000.

[10] See Section 917(c) of the EFTA, 15 U.S.C. Section 1693o(c).

[11] The Board has proposed to cover merchants and other payees who use ECK in point-of-purchase and mail-in transactions. Because of the increasing use of one-time electronic debits in telephone and online transactions, in the future the Board also may wish to cover entities who use one-time electronic debits in these transactions. In telephone and online transactions, like point-of-purchase and mail-in transactions: 1) the transaction begins with a check; 2) source information from the check is used by the merchant/payee; 3) the information is processed as a single debit; and 4) the consumer's account is quickly debited.

The FTC has received complaints (including about unauthorized transactions) from consumers regarding one-time electronic debits in telephone and web purchases. Although, under Regulation E, some form of authorization is needed for all EFTs, the current absence of specific rules for telephone and online transactions means the mandate is vague and difficult to enforce. As a result, consumers may find it difficult to invoke protection under Regulation E to address fraud, including by using the unauthorized transfer rules and error resolution rules and by invoking their private right of action under the EFTA. See Sections 205.6 and 205.11 of Regulation E, 12 C.F.R. §§ 205.6 and 205.11 and Section 915 of the EFTA, 15 U.S.C. § 1693m.

[12] NACHA, the Electronic Payments Association (formerly, the National Automated Clearing House Association) is a private self-regulatory industry organization that establishes

B. AUTHORIZATION AND NOTICE

The Board has proposed requiring that merchants and other payees provide to consumers a clear and conspicuous notice, such as signage at point-of-sale or written statements, to obtain the consumer's authorization for each ECK transaction.[13] The Board has proposed model forms to assist persons providing the notice. The required notice also would inform consumers that: 1) when their checks are processed as EFTs, funds may be quickly debited from their accounts, and 2) for mail-in transactions, consumers will not receive back their checks in their bank statements.[14]

The Commission supports this proposal. The Commission has received complaints from consumers regarding: 1) lack of notice when ECK is used in in-store or mail transactions; 2) lack of understandable notice; 3) confusion about ECK; 4) receipt of confusing explanations about ECK from sellers; 5) concern about transmittal of incorrect amounts; and 6) alleged unauthorized transactions. Clear notices to consumers may assist them in better understanding the ECK transaction, which quickly debits their deposit accounts and could lead to overdrafts absent sufficient funds. Moreover, consumers may be more willing to engage in ECK transactions if they better understand them.

The Board also requested comment on whether in-store merchants should be required to obtain a signed written authorization from the consumer, as opposed to being permitted to post

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standards, rules, and procedures for the automated clearinghouse ("ACH") network. ACH is an electronic funds transfer system that provides for interbank clearing of electronic payments by participating financial institutions. NACHA rules currently require merchants to obtain a written and signed or similarly authenticated authorization from the consumer for in-store ECK transactions. NACHA's rule, however, does not apply to mail-in transactions. See 69 Fed. Reg. at 56,000, n. 6. While violations of NACHA's rules may lead to letters from NACHA to certain entities covered by its mandates and possible monetary repercussions, the rules do not provide for a consumer's private right of action or civil or administrative enforcement.

[13] Proposed Section 205.3(b)(2) of Regulation E; proposed Section 205.3(b)(2)-1 of the Commentary.

[14] A principal purpose of requiring notices in this context is to ensure that consumers are aware of differences in the way payments are handled under the relatively new electronic check conversion process as opposed to traditional check processing procedures. It is worth noting that under the Check Clearing for the 21st Century Act ("Check 21"), banks and other entities are expected to handle more traditional checks electronically (but not as EFTs), which will expedite the processing of traditional checks. As consumers become more familiar with fast electronic processing, whether as ECKs or under Check 21, the need for notices to consumers about ECK may decline over time. As a result, the Board may wish to consider revisiting the need for such disclosures at some point in the future.

signs to provide the requisite notice. NACHA currently requires signed authorization.[15] The Commission agrees that signed written authorization generally is an appropriate and effective means of obtaining authorization.[16] The Commission has no specific data, however, on the costs or feasibility of requiring signed written authorization in every transaction. In addition, the Commission does not have sufficient grounds for concluding that other forms of notice, such as prominently placed in-store signs, could not be adequate.

As discussed below, the Commission also believes that the Board should elaborate on the "clear and conspicuous" requirement to ensure that ECK information is noticeable and understandable to consumers. The clear and conspicuous standard is particularly important for merchants' or other payees' in-store signs, which should be prominent, not hidden or obscured.

C. CLEAR AND CONSPICUOUS INFORMATION, AND CONSUMER RESEARCH

In general, the FTC supports the Board's use of notices and model forms to facilitate compliance and enhance consumer understanding of ECK. These disclosures, however, include technical information and pertain to relatively new electronic payment systems with which consumers may be less familiar than more longstanding options, such as paper checks, credit cards, and even debit cards. Therefore, the Board should provide additional explanation about what constitutes a clear and conspicuous notice in ECK transactions, including by providing examples. In addition, the Board may wish to consider whether the use of consumer research would be helpful in designing text and format for the disclosures envisioned by the proposal.

1. CLEAR AND CONSPICUOUS INFORMATION

The Board intends to make ECK authorization and notices provided to consumers subject to Regulation E's "clear and conspicuous" standard.[17] The Commission suggests that, to assist both consumers and businesses, the Board consider providing further explanation regarding the application of this standard to ECK, including by providing examples. Consumers who received ECK disclosures have complained to the FTC that the information was: 1) for mail-in transactions – buried in fine print and placed on the back of or in the middle of unrelated credit card information on periodic statements; and 2) for in-store transactions – hidden from view, obstructed by large ads for special discounts, or inconspicuously placed on the side of cash

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[15] See http://www.nacha.org. NACHA permits merchants to use "similar authentication" as well. Neither the NACHA rule, nor the Regulation E proposal, requires signed authorization for mail-in transactions.

[16] In a consumer's dispute regarding an unauthorized in-store transfer, a signed written authorization also may be helpful in determining whether the consumer, in fact, authorized the transaction.

[17] 69 Fed. Reg. at 56,000.

registers.[18] The Commission recommends that the Board clarify that these practices would not meet the "clear and conspicuous" standard.

Consumer information is also clearer if it avoids fine print and technical terms.[19] Adding language to the Commentary that adapts these concepts to ECK transactions could be useful to consumers, foster compliance, and facilitate enforcement. For example, the Commentary could emphasize the need for noticeability and understandability of information and note that use of fine print would not be sufficient. FTC publications discussing case law and other regulatory requirements[20] and other consumer financial laws provide additional guidance on this issue.[21]

2. CONSUMER RESEARCH

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[18] Some consumers reported receiving no explanation or an insufficient explanation from sales clerks who handed back checks, after ECK processing, that were stamped "void." Other consumers have reported not receiving any ECK disclosures, which they later learned should have been provided.

[19] See FEDERAL TRADE COMM'N, GETTING NOTICED: WRITING EFFECTIVE FINANCIAL PRIVACY NOTICES, at http://www.ftc.gov/bcp/online/pubs/buspubs/getnoticed.htm. Notices are more effective if they use plain language, avoid legal jargon, and recognize that customers may not be familiar with the applicable issues. Id. In determining what is "clear and conspicuous" for purposes of the Fair Credit Reporting Act, which does not define the term, a federal appellate court recently looked to other statutes, including the Uniform Commercial Code and Truth in Lending Act. It considered the following factors: "the location of the notice within the document, the type size used within the notice as well as the type size in comparison to the rest of the document . . . whether the notice is set off in any other way – spacing, font style, all capitals, etc. . . there must be something about the way that the notice is presented in the document such that the consumer's attention will be drawn to it." Cole v. U.S. Capital, Inc., No. 03-3331, 2004 U.S. App. LEXIS 24177, at *27 (7th Cir. Nov. 19, 2004).

[20] See FEDERAL TRADE COMM'N, DOT COM DISCLOSURES, at http://www.ftc.gov/bcp/online/pubs/buspubs/dotcom/index.html.

[21] For example, Regulation M's Commentary offers the following explanation of the "clear and conspicuous" standard for written disclosures: "disclosures must be presented in a way that does not obscure the relationship of the terms to each other . . . and . . . must be legible, whether typewritten, handwritten, or printed by computer." See Section 213.3(a)-2 of Regulation M's Commentary, 12 C.F.R. § 213.3(a)-2, Supp. 1. The Consumer Leasing Act amends the TILA; implementing Regulation M is at 12 C.F.R. § 213. Regulation M also provides the following explanation for advertising disclosures: "very fine print in a television advertisement or detailed and very rapidly stated information in a radio advertisement does not meet the clear-and-conspicuous standard if consumers cannot see and read or hear, and cannot comprehend, the information required to be disclosed." Section 213.7(b)-1 of Regulation M's Commentary, 12 C.F.R. § 213.7(b)-1, Supp. 1.

In the FTC's experience, it is possible that well-intentioned disclosures can be drafted in ways that inadvertently cause consumer confusion and result in unintended consumer impressions.[22] Although the FTC supports the Board's proposal to create model notices and forms for ECK authorization, the Board may wish to consider using consumer research to determine the most effective format and text for this information. Consumer research (including consideration of diverse socio-economic and educational backgrounds) may be helpful in clarifying how the intended audience perceives the information, and may reveal effective alternatives for complex financial information. The changes resulting from such consumer research (sometimes consisting of simple revisions) may enhance comprehension and eliminate confusion.

For example, the Board's proposed model forms use technical terms, such as "payee," and "electronic fund transfer," and potentially unclear phrases, such as "we may process your payment as a check" or "use your check to make an electronic fund transfer."[23] It is not clear to what extent consumers understand these terms and phrases and whether the notices will serve their intended purpose, or whether alternative language would be preferable.[24] The Board may, therefore, wish to consider whether the use of focus groups or other consumer research that could be conducted within a reasonable timeframe could be helpful to test, assess, and, where appropriate, revise, the proposed notices.[25] The staff of the FTC's Bureaus of Consumer Protection and Economics are available to consult with the Board regarding consumer testing.

II. PREAUTHORIZED TRANSFERS

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[22] See "The Effect of Mortgage Compensation Disclosures on Consumers and Competition: A Controlled Experiment," Federal Trade Commission Bureau of Economics Staff Report, by James M. Lacko and Janis K. Pappalardo (Feb. 2004). See also "The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment . . . or Why Disclosures are Tricky," presented by James M. Lacko and Janis K. Pappalardo, FTC Bureau of Economics at "Reflecting on Thirty-five Years of Consumer Disclosure Regulation" at Georgetown University Credit Research Center, Washington, D.C. (Oct. 5, 2004).

[23] See proposed Appendices A-2 and A-6.

[24] Consumer research and testing could help answer the following questions: How will consumers interpret and understand the particular disclosures? How will the disclosures affect consumer decisions? Would other text or formats be simpler and more suitable?

[25] The Board also has proposed alternative disclosures to allow merchants and payees to disclose that they may process a transaction as either an ECK or as an electronic check under Check 21. See 69 Fed. Reg. 56,001. See also note 14, above. The Board's proposed model forms for these disclosures use some technical terminology with which consumers may not be familiar. Because ECKs and electronic processing under Check 21 differ and because consumers may have less familiarity with these systems, testing on disclosures in this area could be especially useful.

Under EFTA and Regulation E, special rules apply to preauthorized transfers that involve recurrent debits taken from a consumer's deposit account over time, such as recurrent debits to pay monthly utility bills.[26] These rules allow preauthorized transfers to be authorized only by a writing signed or similarly authenticated by the consumer, and they require that a copy of such authorization be provided to the consumer when made.[27] These rules protect consumers against fraudulent and unauthorized continuing withdrawals from their deposit accounts.[28]

A. REMOVAL OF PROHIBITION ON TAPED ORAL AUTHORIZATION

Currently, the Commentary states that a tape recording of a telephone conversation with a consumer who agrees to preauthorized transfers does not constitute valid written authorization of the transfers under Regulation E.[29] The Board has proposed withdrawing this interpretation in response to industry concerns that this guidance may conflict with ESIGN.

The Commentary's statement that a tape recording does not constitute valid written authorization of preauthorized transfers has provided a safeguard against pernicious deceptive telemarketing sales practices. For example, the FTC has brought a number of law enforcement actions against telemarketers or sellers that enrolled consumers in "negative option programs" in which the consumer's silence or failure to act affirmatively to reject goods or services or cancel the agreement was deemed by the seller to be acceptance of an offer. These cases often have involved a

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[26] See Section 903(9) of the EFTA, 15 U.S.C. § 1693a(9), and Section 205.2(k) of Regulation E, 12 C.F.R. § 205.2(k).

[27] See Section 907(a) of the EFTA, 15 U.S.C. §1693e(a), and Section 205.10(b) of Regulation E, 12 C.F.R. § 205.10(b). The "similar authentication" rule permits signed, written authorizations to be provided electronically; that provision also states that the writing and signature requirements of the preauthorized transfer rule are met by complying with the Electronic Signatures in Economic and Global Commerce Act of 2000 ("ESIGN"). 15 U.S.C. § 7001 et seq. See Section 205.10(b)-5 of the Commentary, 12 C.F.R. § 205.10(b)-5, Supp. 1.

[28] While the use of recurrent debits can have significant cost and convenience benefits for consumers, they also can have significant adverse consequences. First, the transactions withdraw funds from consumers' accounts. The withdrawal can be immediate and, if the consumer lacks sufficient funds, can lead to virtually instantaneous overdrafts, additional fees, adverse credit ratings or other harm. Second, unauthorized use protections for EFTs differ from those for credit cards. Consumer liability is capped at $50 for unauthorized charges on credit cards. See Section 226.12(b) of implementing Regulation Z, 12 C.F.R. § 226.12(b). Liability for unauthorized EFTs, on the other hand, is contingent upon the timing of the consumer's claim. See Section 205.6 of Regulation E, 12 C.F.R. § 205.6. Differences also exist in the dispute mechanisms between the billing error rules of Regulation Z (credit cards), Section 226.13 of Regulation Z, 12 C.F.R. § 226.13, and the error resolution rules for EFTs, Section 205.11 of Regulation E, 12 C.F.R. § 205.11.

[29] Section 205.10(b)-3 of the Commentary. 12 C.F.R. § 205.10(b)-3, Supp. 1.

"free" trial offer, which automatically converted to mandatory payments unless the consumer canceled before the end of the trial period. In these cases, the sellers or telemarketers allegedly did not disclose adequately the terms of the negative option feature and failed to obtain affirmative authorization for recurrent charges that they made to consumers' deposit accounts.[30] The FTC continues to bring cases challenging these practices.[31]

In certain FTC investigations, companies have produced copies of tape recordings that highlight the problems inherent in using tape recordings to evidence consumer authorization for recurrent debits. These tape recordings have included: 1) taped portions of a telemarketing call containing a consumer's assent to something other than the recurrent transfers; 2) taped portions of calls that revealed ambiguous consumer comments intended as conversation fillers ("uh huh") or that failed to reveal a clear response to the solicitation (as the telemarketer rapidly delivers sales messages); 3) tape recordings that were manipulated or falsified to create the appearance of consumer authorization; and 4) confusing requests to consumers to punch numbers on a telephone keypad to authorize payment.[32]

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[30] See, e.g., U.S. v. Mantra Films, No. CV 03-9184 RSWL (MANx) (C.D. Cal. Aug. 4, 2004). In this case, the court entered a stipulated order containing injunctive relief, consumer redress and other relief to resolve various allegations, including that the defendants telemarketed videos and DVDs to consumers in a negative option program without disclosing material terms of that program and made recurrent debits without consumers' authorization. The complaint charged the defendants with, among other things, violating the EFTA and Section 5 of the FTC Act, 15 U.S.C. § 45. See also America Online, 125 F.T.C. 403 (1998); Prodigy Servs. Corp.,125 F.T.C. 430 (1998), and CompuServe, Inc., 125 F.T.C. 451 (1998) (alleging misrepresentations, failure to disclose material terms and conditions in connection with free trial offers of Internet service, and automatic debiting of checking accounts without obtaining consumers' prior written assent); United States v. Budget Marketing, Inc., No. 88-1698 E (S.D. Iowa Mar. 17, 1997) (consent decree settling charges that telemarketers selling magazine subscriptions failed to obtain written authorization from consumers for preauthorized transfers).

[31] The Commission's Telemarketing Sales Rule ("TSR") requires sellers and telemarketers that use previously obtained ("preacquired") consumer account information for billing purposes in "free-to-pay" transactions (transactions that involve a free trial offer that automatically converts to mandatory payments unless the consumer cancels before the conversion) to tape-record the entire transaction. See TSR, 16 C.F.R. § 310.4(a)(6)(i)(c). See also TSR Statement of Basis and Purpose, 68 Fed. Reg. at 4,621 (Jan. 29, 2003). Of course, the TSR only addresses certain telemarketing transactions and only applies to entities under FTC jurisdiction. Similar problems can occur in other contexts, however, including online or at point of sale.

[32] For example, the consumer can be instructed to "press 2 for yes and 3 for no." It is not always clear to what the "yes" and "no" apply, i.e., to the mailing of one item or repetitive mailings of items. Limited, unclear instructions may be provided for making the selection, and procedures may not exist for cancellation of the process if the consumer accidentally presses the wrong number or changes his or her decision.

The Commentary's current prohibition of tape-recorded authorization has provided a "bright line" approach that has protected consumers from unauthorized recurrent debits to their accounts.[33] The Commission has serious concerns about the potential for abuse or errors if taped oral messages are permitted as preauthorization for recurrent debits. Thus, if the Board decides to remove this prohibition, the Commission recommends, at a minimum, that the Board add to the Commentary the following additional clarifications to ensure that consumers are protected in recurrent debit transactions under Regulation E.

First, the Commission recommends that the Board clarify that a seller or other payee must fully comply with ESIGN if that entity relies upon ESIGN in connection with obtaining the consumer's authorization.[34] Second, the Board should consider clarifying that entities relying on ESIGN to obtain consumer authorization must still comply with the other provisions of the EFTA, Regulation E, and the Commentary. For example, the Board should clarify that, regardless of the type of authorization, a clear and conspicuous copy of the full authorization (including its date and terms) must be provided to the consumer.

Third, the Commission believes it would be useful to add explanatory language such that the authorization must evidence the consumer's full consent to the transaction. For example, explanatory language could be added to Section 205.10(b)-6 of the Commentary, such as:

> Relying upon portions of a consumer's response without showing the full context or material terms of the transaction and the consumer's express agreement to those terms would not satisfy the authorization requirement. Silence or ambiguous consumer comments also do not constitute valid authorization.

Fourth, the Board could also state that an entity must obtain the consumer's "express agreement to be charged for the goods or services and to be charged using the account number," and

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[33] This approach also may help protect against identity theft by ensuring that a writing signed or similarly authenticated – which could be verified – is used for consumer authorization. Identity theft has been the "number one" consumer fraud complaint to the Commission for the past five years. See "FTC Releases Top 10 Consumer Complaint Categories for 2004." http://www.ftc.gov/opa/2005/02/top102005.htm.

[34] This could include clarifying in the Commentary that all applicable aspects of ESIGN must be met, including but not limited to: 1) meeting the full definition of "electronic record," 15 U.S.C. § 7006(4), which encompasses the term "record," which means, among other things, information that is "retrievable in perceivable form," see 15 U.S.C. § 7006(9); 2) meeting the full definition of "electronic signature," which includes "an electronic sound, symbol, or other process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record," see 15 U.S.C. § 7006(5) (emphasis added); and 3) where applicable, meeting the full requirements of Section 101(c) of ESIGN, 15 U.S.C. § 7001(c), providing for consumer consent procedures and other protections.

should identify with specificity the account to be charged.[35] This language would help ensure that the consumer's clear and knowing authorization is obtained before his or her account is repeatedly accessed.

Fifth, in discussing the authorization standard in its Federal Register notice, the Board made various references to the standard's applicability to "institutions."[36] The authorization standard is highly relevant, however, to business entities that are not "institutions" within the meaning of Regulation E, such as telemarketers, traditional retail sellers, online sellers, creditors, and other payees.[37] Therefore, the Commission recommends that the Board revise the language in the final Federal Register notice to clarify its application to those entities, such as by substituting the term "merchants and other payees" or "payees" for "institutions."[38]

B. BONA FIDE ERROR

The Commentary states that a company's failure to obtain written authorization for recurring debits in telephone and online debit card transactions is not a violation of Regulation E, if the failure to obtain written authorization was not intentional, resulted from a bona fide error, and occurred despite the maintenance of procedures reasonably adapted to avoid any such error. Under Regulation E, a company must obtain written authorization for recurrent payments charged to a debit card (but not to a credit card). According to the Commentary, a company's failure to obtain written authorization might be a bona fide error if a consumer indicated during a telephone transaction that he was using a credit card for a recurring payment, when in fact he was using a debit card. If the company later determined that the consumer used a debit card, it must obtain a signed written (or similarly authenticated) authorization as soon as reasonably possible or stop debiting the account.[39]

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35 See TSR, 16 C.F.R. § 310.4(a)(6).

36 69 Fed. Reg. 56,003.

37 "Financial institutions" under Regulation E hold an account belonging to a consumer or issue an access device and agree with a consumer to provide electronic fund transfer services. See Section 205.2(i) of Regulation E, 12 C.F.R. § 205.2(i).

38 In addition, in its Federal Register notice, the Board states that authorization for preauthorized transfers must be readily identifiable "to the consumer" and the terms of the preauthorized debits must be clear and readily understandable "to the consumer," citing Section 205.10(b)-6 of the Commentary. See 69 Fed. Reg. at 56,003. In fact, this provision makes no reference "to the consumer." Accordingly, the FTC suggests including the terms "to the consumer" after each clause in the Commentary provision concerning authorization for preauthorized transfers. The resulting provision would read: "An authorization is valid if it is readily identifiable as such to the consumer, and the terms of the preauthorized transfer are clear and readily understandable to the consumer."

39 Section 205.10(b)-7 of the Commentary, 12 C.F.R. § 205.10(b)-7, Supp. 1.

The Board has proposed to modify the Commentary so as to deem as a reasonable procedure to avoid errors a company's request to a consumer that she specify whether she is using a debit card or credit card. This modification would apply to telephone and online transactions. Under the Board's proposal, if the consumer indicates that she is using a credit card for a recurring payment (or that she is not using a debit card), the company may rely on that statement without seeking further information.

Because of the widespread use of debit cards in telemarketing and online transactions, the Commission agrees that companies in general should be permitted to rely on a customer's specification about the type of card he or she is using. However, the Commission recommends that the Board expressly require companies to ask whether the consumer is using a credit card or debit card to make a recurring payment. A duty to inquire in all circumstances would not be unduly burdensome and would prompt consumers to focus on the type of card they are using in a particular transaction. This approach could help reduce errors regarding the type of card being used.

The Board also should consider clarifying that, in some circumstances, companies should consider additional information as part of its reasonable procedures to avoid error. For example, repeated consumer complaints about unauthorized debits may suggest that a company's procedures to determine whether consumers are using credit or debit cards are insufficient. Thus, the Board could clarify that if a company becomes aware of repeated authorization problems, it should examine its procedures and the circumstances of the erroneous authorizations.[40] Otherwise, consumer after consumer could complain to a company about unauthorized recurrent debit card usage, and a company could continue to have no mechanism in place to prompt corrective changes in its procedures.[41]

III. ERROR RESOLUTION AND THE "FOUR WALLS" RULE

At present, when investigating disputed EFT charges to consumers' accounts under Regulation E, an institution can limit its investigation to "a review of its own records" if the EFT

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[40] The Board might include the following language: "If the payee learns that a pattern of problems may exist because, for example, numerous consumers have complained about unauthorized charges to debit cards, reasonable procedures would include investigation of the problem generally and related changes to its procedures."

[41] In addition, the Commission concurs with the Board's decision, in connection with the reasonable procedure rule, not to require, at this time, that merchants rely on or use BIN (bank identification number) tables to verify that a credit card or debit card is being used. See 69 Fed. Reg. at 56,003. The Commission notes, however, that the recent settlement with respect to Wal-Mart in In Re Visa Check/Mastermoney Antitrust Litigation, No. 96-CV-5238 (E.D.N.Y. Jan. 23, 2004) requires Visa and Master Card to make available to merchants lists of such numbers. Should this information become available in "real-time, online" form in the future, the Board should consider revisiting this issue.

involves a third party with whom the institution has no agreement for the type of EFT involved.[42] This rule is known as the "four-walls" rule. The Board has proposed to clarify that, under this rule, the institution's "own records" would not be limited to a review of its payment instructions, when other information within the institution also could be reviewed to determine whether an error has occurred.[43]

The Commission supports this provision, particularly in view of the fact that EFT payments, as the Board points out, have expanded dramatically since enactment of the "four walls" rule over twenty years ago.[44] Thus, point-of-sale debits, telemarketing transactions, and online transfers are now common occurrences. The Commission's enforcement experience suggests that fraudulent and unauthorized EFTs are not uncommon.[45] The Board notes that the "risk that a consumer's check(s) or checking account number could be used in a fraudulent manner to complete an ACH transfer from the consumer's account was not contemplated when the 'four walls' analysis was adopted, since the typical transfer then involved . . . a known party."[46]

The Board should also consider clarifying that, if an institution possesses information

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[42] Section 205.11(c)(4) of Regulation E, 12 C.F.R. § 205.11(c)(4), and Section 205.11(c)(4) of the Commentary, Section 205.11(c)(4), Supp.1. An agreement authorizing the direct debit of a consumer's monthly utility payment from the consumer's bank account is an example of an agreement between the financial institution and a third party merchant or payee. In many cases, however, the institution has no agreement with third party merchants. Under the four-walls rule, if a consumer disputes an EFT involving a merchant or payee with whom the institution does not have an agreement, the institution satisfies the investigation requirement by informing the consumer that the information concerning the disputed EFT is in the possession of a third party with whom it does not have an agreement. Section 205.11(c)(4)-1 of the Commentary. 12 C.F.R. § 205.11(c)(4)-1, Supp.1.

[43] Proposed Section 205.11(c)(4)-5 of the Commentary.

[44] 69 Fed. Reg. at 56,004. At that time, most EFTs involved preauthorized salary or compensation payments to consumers' accounts or payments from consumers' accounts for utilities or other limited payees.

[45] The Commission recently filed settlements providing for millions of dollars in consumer redress in cases involving fraudulent payment processing and deceptive telemarketing involving the ACH network and consumers' bank accounts, in violation of Section 5 of the FTC Act and the TSR. See, e.g., FTC v. Electronic Financial Group, No. W-03-CA-211 (W.D. Tex. Mar. 23, 2004); FTC v. First American Payment Processing, No. CV 04-0074 PHX SRB (D. Ariz. Nov. 2, 2004).

[46] 69 Fed. Reg. at 56,005. The Board notes that, in the event that a network (such as a debit card network) is used for the transfer, this would likely constitute an agreement under Section 205.11(c)(4) of Regulation E, 12 C.F.R. § 205.11(c)(4). Thus, the institution would be required to look beyond its four walls. Id.

indicating that a particular merchant or other payee is experiencing a high chargeback rate, the institution should consider that information when evaluating a disputed transaction involving that entity. Otherwise, an institution may not give full consideration to reasonably available information that could be relevant to the dispute.

In addition, the Board should consider specifying that the investigation should include review of information that is within the institution's possession or control, not merely within the physical confines of the institution's offices. In the current financial environment, many aspects of an institution's operation may be subcontracted, yet still within its responsibility and control. To the extent such subcontractors are responsible for EFTs, such as for payment processing, investigation of disputes, or related aspects of the payment process, institutions should consider information held by these subcontractors when conducting an investigation.[47]

IV. CONCLUSION

The Commission appreciates your consideration of these views. If any other information would be useful regarding these matters, please contact Carole Reynolds, Senior Attorney, Division of Financial Practices, at (202) 326-3224.

By direction of the Commission.

Donald S. Clark
Secretary

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[47] For example, if an institution's subcontractor for consumer services experienced an error (such as an error with a processor) and, as a result, the system generated duplicate debiting of accounts, that problem should be included in the investigation.