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Dr. Ben Bernanke, Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave.
Washington, D.C. 10551

Re: Essential regulatory and commentary changes to protections for consumers in
electronic commerce

Dear Dr. Bernanke:

We are writing because of our concern about the alarming erosion of critically important protections for consumers under the Electronic Fund Transfers Act ("EFTA"). This erosion causes consumers significant harm, and creates opportunities for exploitation by payday lenders as well as depository institutions that rely on fee income generated due to consumers' inability to track their account balances. As representatives of low and moderate income consumers, we ask you to adopt a series of regulatory and commentary changes -- all of which are within the Federal Reserve Board's authority as the regulator responsible for interpreting the EFTA -- to address these growing problems.

The EFTA was passed in 1978 to facilitate electronic transactions by providing a balanced set of protections to consumers. It was these protections which gave consumers the confidence to begin engaging in electronic financial exchanges.

In today's world, consumers have no choice but to engage in transactions which are electronic, yet many of these transactions are not covered by the EFTA. The payments system in the United States is a confusing myriad of methodologies. The unclear and uneven application of state and federal law causes general bewilderment among consumers regarding their rights, and their ability to protect their money, in deposit accounts. The complex questions of what law applies also make it extremely difficult to educate consumers about the different levels of protection depending upon which very similar payment device is used. Consumers are now at the mercy of a payments system over which they have little control and which provides a multiplicity of confusing options -- often without logical and understandable legal consequences, and often quite dangerous from a financial perspective. Further, the consumer's selection of a payment method no longer dictates which legal regime applies. Instead, the choices of the merchant or its processor may change the legal character of the

payment instrument, resulting in a change in what law applies and in the real and practical obligations and risks for the consumer.

The EFTA could still provide a straightforward set of legal protections if it were applied across the board to all consumer financial exchanges which are electronic in whole or in part. We ask the FRB to acknowledge the untenable state of current law and use its interpretative power under Regulation E to define the scope of the EFTA in a way that will bring all payment methods which are initiated or processed in whole or in part by electronic means under its baseline protections.

We respectfully urge the Board to make the following five changes to Regulation E and the Official Staff Commentary on Regulation E:

1. Amend the Official Staff Interpretations of Regulation E to clarify that remotely created checks are covered by the EFTA.
2. Amend Regulation E to ensure that the debiting of consumer's accounts by internet payday lenders is subject to all the rules applicable to preauthorized electronic fund transfers unless the lender expressly prohibits any extension, rollover or renewal of the loan.
3. Amend the Official Staff Interpretations of Regulation E to clarify that consumers need not be required to inform the payee in order to stop payment on preauthorized electronic transfers.
4. Amend Regulation E to define multiple representation of an electronic debit as unauthorized.
5. Amend Regulation E to prohibit the practice of charging consumers a fee to revoke authorization for preauthorized electronic fund transfers.

The problems with the Board's EFTA regulations and commentary, and the need for these changes, are best illustrated in the context of payday lending.

Internet payday loans, their abuses, and the harm to consumers.

Payday loans are extremely expensive extensions of credit that trap consumers in a cycle of renewals, extensions and rollovers from which they find it difficult if not impossible to emerge. The industry uses abusive collection tactics such as the threat of criminal actions for bad checks not only in attempts to collect but also to bully consumers into extensions and renewals at triple-digit interest rates.

In the last several years the industry has expanded from store-fronts to the Internet. Internet lenders are often hard to identify, locate, or contact. Internet payday lenders routinely evade state consumer protections by locating in lax regulatory states or foreign jurisdictions and making loans without complying with state protections in the borrower's home state. As a condition of the loan, Internet payday lenders require consumers to authorize electronic debiting of their bank accounts on the next payday and routinely establish the automatic rollover or a renewal of the loan. For example, for an initial loan of \$200, the consumer would authorize a debit of \$260 two weeks from the date of the loan. Unless the consumer faxes a request three days in advance of the due date, and two weeks after the initial loan the lender will deduct the \$60 finance charge and renew the \$200 loan for another pay cycle. Two

weeks later, an additional \$60 is debited and the \$200 is still due two weeks after that. This cycle will continue for many weeks.

It is very difficult for a consumer to stop electronic debiting for an Internet payday loan. Consumers report that their financial institutions refuse to stop payment on preauthorized electronic transfers despite sufficient notice. Sometimes banks require the borrower to direct the Internet payday lender to stop debiting the account or require that the borrower confirm with the lender in writing that authorization has been revoked. Many payday lending contracts specify that if authorization for the electronic fund transfer is revoked, then the lender will use a remotely created check to debit the very same amount from the borrower's account. Lenders switch back and forth from traditional electronic fund transfers to remotely created checks. Lenders change routing numbers and submit the debit under different names to avoid the consumer's efforts to stop payment. Often the lender will submit the same debit multiple times, so the consumer incurs multiple dishonored check fees.

The transaction used to debit the consumer's account to make payments on an Internet payday loan appears to fall squarely within the definition of an electronic fund transfer of both the EFTA and Regulation E. Consumers who authorize transfers from their accounts for internet payday loans do so electronically, by computer or telephone, without using a paper instrument. Whether the lender decides to process the transaction using a typical electronic fund transfer or by use of a remotely created check, the consumer initiated the transaction electronically. The consumer has no control over how the transaction will be processed and is completely unaware if the loan payment has been completed as a remotely created check or under the EFTA. The actions taken by the consumer are the same, providing account information and authorization over the phone or internet, but the protections provided differ substantially. Treating these transactions as electronic fund transfers would preserve for consumers the important protections of the EFTA¹ regardless of whether the payee uses a remotely created checks rather than processing the transaction as an electronic fund transfer.

Steps the Federal Reserve Board should take to protect consumers.

We oppose payday lending and the practice of check-holding and debit authorization requirements as the basis or security for cash loans. In the meantime, the FRB needs to address the weaknesses in EFTA and Regulation E that aid and abet this modern version of wage assignment. To reduce the abusive treatment of consumers in Internet payday loan transactions, the Federal Reserve Board should:

- 1. Amend the Official Staff Interpretation of Regulation E to add as a definition of electronic transaction: “205.3(b)(1) vii. Any debit of a consumer’s account not initiated by the consumer’s use of a paper instrument.”**

¹ If the transfer is covered by EFTA, consumer liability for an unauthorized transfer using an access device is limited to \$50 provided there is timely notification to the financial institution. The burden is on the institution to show the transfer was not unauthorized. The consumer is afforded the protections of the error resolution procedure of the Act, including timelines for recredit. Finally, if the transaction is properly identified as a preauthorized transfer then the extension of credit itself cannot be conditioned on the consumer's authorization for such transactions; and if the consumer timely notifies his or her financial institution to stop payment on the transfer, the institution must block all future payments for the particular debt. This would limit the free access the lender would like to have to the consumer's account

The definition of an electronic transfer under the EFTA is “any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account.”² Although remotely created checks do involve a paper instrument, this instrument is created by the payday lender, not the consumer, and is typically used after the consumer has revoked authorization for the lender to debit the account by electronic fund transfer. These transactions are in fact initiated electronically, by virtue of the consumer’s prior authorization via the Internet.

The exception in both the EFTA and Regulation E is for transactions “originated” by paper instruments. In the Internet lending context and most other circumstances where consumers authorize remotely created checks, the paper is generated by the payee, and not by the consumer. The consumer’s authorization for the debit is electronic. If the transaction is wholly or partly electronic, whether because of the nature of the consumer’s authorization or because of the manner in which the payment is processed, then the baseline protections of Regulation E should apply.

Clarifying that remotely created checks are electronic fund transfers covered by the EFTA would provide the important protections of the EFTA for consumers in Internet payday lending transactions. It would curb many other abuses. Demand drafts are so often unauthorized, either in whole or with respect to the amount for which they are prepared, that a group of 38 state Attorneys General called for their abolition in 2005. (See comments filed May 9, 2005, in Docket No. R-1226). When one community bank in Wisconsin monitored every third-party draft for 16 months and phoned account holders that did not provide written authorization, 73% of the drafts were returned as unauthorized. Remotely created checks are often used by those who cannot obtain an ACH merchant account. This makes it very difficult for enforcement agencies or consumers to trace the use of demand drafts initiated by fraudulent telemarketers, Internet gambling operations, and Internet payday lenders. That these abuses continue was documented just last Sunday by a feature article in the *New York Times*.

2. Amend Regulation E 205.2(k) to read as follows: “Preauthorized electronic fund transfer means an electronic fund transfer authorized in advance to recur at substantially regular intervals, including any authorization of electronic fund transfers provided to repay a consumer loan unless the lender expressly prohibits any extension, rollover or renewal of the loan. A new loan made within one month to the same borrower will be considered a renewal of the loan for the purposes of this rule.”

Internet payday lenders attempt to cloak loan repayment transactions under the guise of a one-time transfer. Generally the transfers are repeated and recurring either through an automatic renewal of the loan or a new loan used to pay off the existing loan.³ Even lenders that require payment in full under the terms of the contract will often solicit the borrower to take out a new loan to pay off the old. The payment of the loan becomes a recurring payment and meets the definition of recurring payment under the EFTA.

² 15 USC 1693a(6).

³ Fewer than half of the sites that the Consumer Federation of America surveyed in 2004 required payment in full on the next payday.

The EFTA charges the Board to “prescribe regulations to carry out the purposes of this subchapter.”⁴ The stated primary objective of the subchapter is “the provision of individual consumer rights.”⁵ To prevent internet lenders from evading the protections afforded by the EFTA, the FRB should ensure that these transactions are covered by the preauthorized transfer portion of the Act. Such an amendment would more accurately reflect the true nature of the transfers that are occurring. If the lender really intends that the transaction will be a one-time transfer rather than a recurring transaction, it may simply prohibit any extension, rollover or renewal of the loan or the issuance of any new loan within one month after a loan is repaid.

3. Amend the Official Staff Interpretation of Regulation E 205.10(c)2 as follows:
Revocation of authorization. **Once a financial institution has been notified that the consumer's authorization is no longer valid, it must block all future payments for the particular debit transmitted by the designated payee-originator. The institution may not wait for the payee-originator to terminate the automatic debits. The institution may ~~confirm that the consumer has informed the payee-originator of the revocation (for example by requiring a copy of the consumer's revocation as written confirmation to be provided within fourteen days of an oral notification).~~ require written confirmation to be provided to the institution within 14 days of an oral notification at an address provided by the institution to the consumer if the institution advises the consumer of this requirement at the time it receives the oral notification. If the institution does not receive the required written confirmation within the 14-day period, it may honor subsequent debits to the account.**

The EFTA requires a financial institution that has been notified by a consumer to stop payment on a preauthorized electronic transfer to block all future payments for the particular debt. However, the Board has stated in its Official Staff Commentary to Regulation E that “the institution may confirm that the consumer has informed the payee-originator of the revocation (for example, by requiring a copy of the consumer’s revocation as written confirmation to be provided within 14 days of an oral notification).” This implies that consumers may be required to inform the payee in order to revoke authorization and banks are informing consumers that this is the case.

Requiring consumers to inform the payee in order to revoke authorization is contrary to section 1693e of the EFTA and section 205.10(c) of Regulation E, which state that the consumer may stop payment by “notifying the financial institution.” The EFTA does allow that “[t]he financial institution may require written confirmation to be provided to it within fourteen days of an oral notification if, when oral notification is made, the consumer is advised of such requirement and the address to which such confirmation should be sent.” This is different than requiring the consumer to notify the payee, whom the consumer may not be able to identify. This amendment to the Commentary would remove the difficult burden of determining the name and address of the payee. Neither the Act nor Regulation E was intended to place such a burden on individual consumers.

⁴ 15 USC 1693b(a)

⁵ 15 USC 1693(b).

Notifying the payee is particularly difficult in Internet payday loan transactions. Often the lender is an offshore company. Or it may be one of a host of related entities that shuffle functions, making it impossible for the consumer to figure out what entity is actually the lender. Payday lenders do not want consumers to revoke authorization for electronic fund transfers and make it as hard as possible for consumers to reach them.

Based on previous discussions with Board staff, we were under the impression that this erroneous and misleading commentary section was going to be revised. We are unhappy to see that this commentary section remains unchanged, even while the Board is moving forward with other changes in Regulation E which appear to have been sought by industry, such as the proposal to reduce the EFTA receipt protection.

4. Amend Regulation E 205.2(m) to add “If a financial institution rejects an electronic fund transfer because of insufficient funds, it is considered unauthorized after the first representment.”

The prospect of multiple representment of a debit authorization is one means by which payday lenders abuse borrowers. While a borrower’s authorization of a debit might be considered to encompass a representment if funds are unavailable, by no means can it be construed as authorization for a lengthy string of representments. Multiple representments are particularly unfair and abusive in the payday loan context, since the lender took the electronic fund transfer authorization while knowing that the consumer did not have sufficient funds in the account. For this reason, payday lenders should be limited to a single representment. The consumer will still be charged two NSF fees by the bank and two NSF fees by the payday lender, on top of the obligation to repay the principal and finance charges, but this change will prevent more than two NSF fees.

5. Prohibit the practice of charging consumers a fee to revoke authorization for preauthorized electronic fund transfers.

Banks are required by the EFTA to honor a consumer’s request to revoke authorization of a preauthorized transfer. Some banks charge consumers a fee to stop payment of preauthorized transfers. This reduces the right to revoke provided by the EFTA to a privilege to be purchased from, and generate income for, the bank. The EFTA, 15 U.S.C. § 1693e, gives the consumer the unconditional right to stop payment of a preauthorized transfer simply by notifying the financial institution up to three days before the scheduled date of the transfer. The Federal Reserve Board should amend Regulation E to prohibit financial institutions from conditioning this right upon the consumer’s payment of a fee.

Conclusion.

We thank you for your consideration of these important issues. We also urge you to follow up on your expansion of Regulation E to cover payroll cards, by expanding the definition of “account” to include all cards which are marketed or used as account substitutes or which hold amounts significant to a household. This issue was spelled out in more detail in the October 28, 2004, comments of Consumers Union and others in Docket No. R-1210.

Sincerely yours,

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