

COMMENTS
to the
Consumer Financial Protection Bureau
regarding
Streamlining Inherited Regulations
Docket No. CFPB -2011-0039
76 Fed. Reg. 233 (December 5, 2011)
by the
National Consumer Law Center

March 5, 2012

Thank you for the opportunity to comment on streamlining regulations the Bureau of Consumer Financial Protection (the Bureau) has inherited from other federal agencies. The National Consumer Law Center is filing these comments on behalf of its low-income clients.¹

The National Consumer Law Center, Inc. (NCLC) is a nonprofit Massachusetts corporation, founded in 1969, specializing in low income consumer issues, with an emphasis on consumer credit. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Consumer Banking and Payments Law* (4th ed. 2009); *Credit Discrimination* (5th ed. 2009 and Supp.); *Foreclosures* (3d ed. 2010 and Supp.); and *Truth in Lending* (7th ed. 2010 and Supp.).

In part one of our comments we offer our highest priorities for updating specific sections of the inherited regulations, followed by other areas we believe the Bureau should consider. Section two outlines our responses to questions posed by the Bureau concerning potential streamlining opportunities.

SUMMARY

I. PRIORITIES FOR UPDATING, MODIFYING, OR ELIMINATING PROVISIONS OF INHERITED REGULATIONS.

1. The Bureau Should Specify a Single Processing Order for Checking Accounts.
2. Eliminate Loopholes that Create Complexity by Deeming Single Payment Loans to Be Closed-End Credit Under TILA and Protected By The Preauthorized Transfer Provisions of the EFTA.
3. Eliminate Exceptions to TILA’s Definition of “Finance Charge.”
4. Adopt the FTC Staff Summary for the Fair Credit Reporting Act.
5. Require Mortgage Creditors to Pay All Closing Costs as Overhead.

¹ These comments were written by Jeremiah Battle, Jr., Elizabeth De Armond, Andrew Pizor, Lauren Saunders, Chi Chi Wu, Margot Saunders, and other National Consumer Law Center staff attorneys.

6. Eliminate Exceptions to Consumer Protection Rules.
7. Clarify Language in Regulation Z That Has Led to Costly and Unproductive Litigation About Whether Truth in Lending Claims Should Be Filed in State or Federal Court.
8. Make It Even Clearer That a Consumer Who Rescinds a Transaction Under TILA Need Not First Tender the Loan Proceeds.
9. Replace Erroneous References to “primary” in Regulation Z with “principal.”
10. Adopt a Single, Standardized Definition of “business day” and “weekend or holiday” for Regulations X and Z That Uses the Generally Accepted Meaning of the Terms.
11. Clear Up Other Inconsistencies in the Truth in Lending Regulations.
12. The Bureau Should Set a Time Frame for Pre-Adverse Action Notices for Employment Uses of Consumer Reports.
13. The Bureau Should Eliminate the Credit Score Disclosure Exceptions to the Risk-Based Pricing Rule.
14. The Bureau Should Eliminate the Confusing Exception for Deferred Interest Plans.
15. The Bureau Should Eliminate the Exception for Convenience Checks.
16. The Bureau Should Eliminate the EFTA Exception For Payments that Originate By Check and Should Ban Remotely Created Checks.

II. THE BUREAU SHOULD NOT ROLL BACK CRITICAL CONSUMER PROTECTIONS IN THE NAME OF STREAMLINING.

We believe that there are many areas in which regulations can be simplified and streamlined by eliminating loopholes that add complexity. Streamlining regulations in this manner will strengthen consumer protection, simplify compliance by eliminating ambiguities, and level the playing field between good industry actors who comply with both the letter and spirit of a regulation and those who would engage in complex manipulations to avoid the law, tempting others to do the same.

There are many opportunities for win-win streamlining, but our top priorities are:

1. The Bureau Should Specify a Single Processing Order for Checking Accounts.

As the Bureau knows, some banks have engaged in the manipulation of payment order to increase overdraft fees. These banks will clear transactions to an account not in the order in which they are received, but from highest to lowest in amount. Posting transactions in order from highest to lowest maximizes overdraft fees. A federal judge in California found this practice to be

unfair and fraudulent under California law, and that “the only motives behind the challenged practices were gouging and profiteering.”²

The legal treatment of transaction ordering is now all over the map. The FDIC has its guidelines, which prohibit transaction reordering to maximize overdraft fees. The OCC has issued a proposed guidance that is less restrictive but also ambiguous. Numerous courts have been asked to determine which ordering methods are unfair or deceptive.

Banks do not have clarity about what methods are permitted, and what will be deemed unfair, deceptive, or abusive. Certain banks that do not engage in this practice are at a competitive disadvantage. Others are willing to change their methods but do not want to engage in the cost or changing their systems until they know which method all regulators and courts will accept and will not put them at a disadvantage with competitors.

The Bureau should adopt a rule that specifies a processing order for checking accounts that minimizes overdraft fees. This rule should categorically prohibit clearing transactions in order from highest to lowest in amount.

2. Eliminate Loopholes that Create Complexity by Deeming Single Payment Loans to Be Closed-End Credit Under TILA and Protected By The Preauthorized Transfer Provisions of the EFTA.

Single, balloon payment loans such as bank payday loans, overdraft loans and internet payday loans exploit loopholes in the Truth in Lending Act (TILA) and Electronic Fund Transfer Act (EFTA). Some lenders, but not all, characterize their loans as open-end credit and thus are able to avoid disclosing any APR, or a grossly deceptive one, and also avoid complying with state usury laws and the Military Lending Act. Lenders also escape EFTA protections and have an incentive to structure their loans as more unaffordable balloon-payments than as installment loans.

a. Close the TILA Open-End Credit Loophole.

If all single and double-payment loans like payday loans, deposit advance loans, and overdraft loans were deemed to be closed-end credit, it would simplify disclosures, make them more meaningful, and make comparison shopping and compliance easier. The determination for whether loans are open or closed-end (and the implications of both) can be complex. Thus, it would be less complicated to simply provide that if a loan is due in a single payment (or two, to avoid evasions), the loan is a closed end loan.

Such a rule would also improve disclosures and prevent circumvention. Disclosures for open-end credit are not required to include fees, which often comprise the most expensive components of these high cost loans. As each of these loans are in fact individual extensions of credit, with single and specific dates of repayment (generally the date the next electronic deposit lands in the consumer's bank account), there is no reason for them to be treated as open end. Compliance

² Gutierrez v. Wells Fargo, 730 F. Supp. 2d 1080, 1112 (N.D. Cal. 2010).

would be simplified, and manipulations designed to avoid consumer protections would be avoided.

b. Close the EFTA single payment loophole.

Similarly, the EFTA treats recurring debits (called “preauthorized electronic funds transfers”) differently than single electronic fund transfers (“EFTs”) that are authorized in advance. The EFTA spells out the authorization requirements for recurring EFTs but not single ones. Consumers have the right to advance notice about changes in the amounts of a recurring debits but not for advance authorization of a single payment. Similarly, consumers can put a stop payment on a preauthorized debit, but not on a single payment.

Most importantly, the EFTA includes a prohibition against requiring the consumer to agree to electronic debiting as a condition of credit, which is a critically important protection as it allows the consumer to choose to repay credit without permitting the creditor unfettered access to the consumer’s bank account. The prohibition currently applies, however, only to preauthorized debits, which are anticipated to be recurring. Many loans, such as overdraft advances, payday loans, and deposit advance loans, are structured as single payment loans—generally immediately due after the electronic deposit of the funds into the consumer’s bank account. There is no reason that these types of credit should be permitted to mandate electronic debit; the harm that results to the consumer is the same—the creditor has the legal ability to reach right into the bank account and remove money that the consumer needed to use for housing, food or other necessities.

Lenders escape the EFTA’s protections even if single payment loans do in fact recur regularly. Even if they do not, consumers need the same protections for single payments. In 1974, when the EFTA was passed, Congress did not envision use of EFTs for single payments and certainly not the way in which single payment EFTs would be authorized in advance and used to avoid the EFTA. Consequently, the Bureau can use the modification authority of 15 U.S.C. § 1693b(c) to ensure that all EFTs are protected, consistent with the purpose of the EFTA to protect consumer rights.

The single-payment loophole also gives lenders the perverse incentive to structure loans as unaffordable balloon payments, which lead to rollovers, rather than more affordable installment loans. Many credit unions, for example, that offer small loans as rates under 36% APR structure them as single payment loans.

Treating all single payment loans as closed-end loans, and all preauthorized EFTs as protected by the EFTA, will simplify compliance will protecting consumers.

3. Eliminate Exceptions to TILA’s Definition of “Finance Charge.”

The legislators who enacted TILA hoped it would enhance competition in the marketplace and stabilize the national economy through disclosure. Since that brave beginning, both Congress and the Federal Reserve Board have largely undercut TILA’s key disclosures, the finance charge and annual percentage rate (APR), by providing creditors with an ever-increasing list of

exceptions.³ The numerous exceptions follow at best a Byzantine logic and complicate creditors' compliance efforts and regulators' review. The exceptions also give unscrupulous lenders a roadmap for how to evade TILA. Failure to provide meaningful disclosure of the cost of credit may have played some role in the subprime mortgage debacle.⁴ Eliminating the exceptions to the definition of "finance charge" will benefit both consumers and creditors.

Eliminating the exceptions will streamline the regulation and benefit creditors by simplifying compliance and reducing litigation risk. Currently creditors—especially mortgage creditors—must carefully evaluate each charge related to the extension of credit in order to determine whether it should be treated as a finance charge or part of the amount financed. This requires complex legal guidance and expensive software to manage the process. Mistakes can violate TILA, resulting in damages, legal fees, and for some mortgages rescission. Eliminating the exceptions would save creditors time and money. If all creditors were subject to the revised "all-in" finance charge, nobody would suffer a competitive disadvantage.⁵ Consumers would benefit from meaningful disclosures without loopholes.

The Federal Reserve Board raised a similar proposal in its mortgage proposal of 2009.⁶ We submitted extensive comments in response to the Board's proposal.⁷ Those comments are relevant to our current suggestion and we incorporate them herein by reference.

a. Cap Application and Participation Fees and Permit Only One or the Other.

Outside of the mortgage market, some lenders, like payday lenders, fee harvester credit cards, bank payday lenders, credit unions and others have manipulated and distorted the APR—deceiving consumers and sometimes evading state usury caps—by building the cost of credit into an application fee and/or a monthly or other type of participation fee, which are excluded from the finance charge. The rules describing what counts as an application fee or a participation fee are vague and complicated, leading to regulatory uncertainty and, at time, litigation costs. The Bureau should eliminate the old regulations, and instead permit lenders to charge only an application fee up to a specific amount, based on the type and amount of credit. The Bureau should prohibit more than one application fee per year for subsequent loans. Similarly, the

³ See generally Elizabeth Renuart & Diane E. Thompson, *The Truth, The Whole Truth, and Nothing But The Truth: Fulfilling The Promise of Truth In Lending*, 25 Yale. J. Reg. 181, 209 (2008).

⁴ Oren Bar-Gill, *The Law, Economics, and Psychology of Subprime Mortgage Contracts*, 94 Cornell L.Rev. 1073 (2009) (arguing that an improved APR could aid consumer-decision making and improve competition and pricing in the subprime mortgage market).

⁵ See, e.g., H.R. Rep. No. 90-1040 (1967), as reprinted in 1968 U.S.C.C.A.N. 1962, 1970 ("Significantly, no one segment of the industry feels it can afford to reform itself by disclosing an annual percentage rate without incurring a competitive disadvantage. Clearly, the only solution is to require by legislation that all creditors use the same method"); *id.* at 1999–2000 (Supplemental Views of Leonor K. Sullivan) ("Out of the operations of this legislation should come needed help to the decent elements in this vital industry in overcoming unfair and dishonest competition from an unscrupulous minority engaging in practices which too often discredit credit and dishonor its ethics."); S. Rep. No. 96-368, at 16 (1979), as reprinted in 1980 U.S.C.C.A.N. 236, 252 (crediting TILA with a reduction in high cost credit from 1969 to 1979).

⁶ 74 Fed. Reg. 43,232 (Aug. 26, 2009).

⁷ Comments to the Federal Reserve Board by NCLC et al. regarding Docket No. R-1366, at 23 (Dec. 24, 2009), available at www.nclc.org/images/pdf/foreclosure_mortgage/predatory_mortgage_lending/r-1366-with-app-dec09.pdf.

Bureau should define the types of costs that may be covered by a participation fee (such as the costs of maintaining an open credit line but not costs of credit, defaults or customer service) and should specify the amount of a permissible participation fee based on the type and amount of credit. The Bureau should prohibit the application or participation fee from being used to undermine the APR.

Limiting the fees that are excluded from finance charges will not cap price that creditors may charge for credit, it will merely require that the price be more honestly disclosed.

4. Adopt the FTC Staff Summary for the Fair Credit Reporting Act.

One simple measure that the Bureau could take to ensure clarity and reduce confusion is to adopt the Federal Trade Commission’s report entitled “40 Years of Experience with the Fair Credit Reporting Act: An FTC Staff Report with Summary of Interpretations” (herein referred to as the “FTC Staff Summary”). As the Bureau knows, the FTC Staff Summary replaced the prior FTC Statement of General Policy or Interpretation, also known as the FTC Staff Commentary. The FTC updated the Staff Summary to reflect changes made by the Consumer Credit Reporting Reform Act of 1996 and the Fair and Accurate Credit Transactions Act of 2003.

For over 40 years, the FTC Staff Commentary was the cornerstone of regulatory guidance for the FCRA. Both consumer advocates and industry members relied heavily on the FTC Staff Commentary in interpreting the FCRA. Even though the FTC never had plenary general rulemaking authority over the FCRA, the FTC Commentary was often regarded as persuasive by consumer advocates, industry and the courts. Indeed, for nearly 30 years, the authors of the Fair Credit Reporting manual published by the National Consumer Law Center cited the FTC Staff Commentary dozens (if not hundreds) of times in its text.

The Bureau should adopt the FTC Staff Summary to avoid uncertainty in interpreting the FCRA. Such adoption will benefit both consumers and industry members, for whom guidance is essential for compliance purposes. Failure to adopt the FTC Staff Summary will result in confusion and additional compliance costs as stakeholders are faced with differing or even conflicting interpretations of the FCRA. We know of one example already. In the FTC Staff Summary, the exception for “joint users” of consumer reports was removed as a permissible purpose;⁸ however, the Bureau Exam manual still includes the joint user exception.⁹ Thus, it is unclear whether the joint user exception is still valid or not.

We recommend that the FTC Staff Summary be adopted in a wholesale fashion. Certainly, there are provisions that consumer advocates disagree with, as well as those that industry disagrees with, as well as those we both support. A simple and fair way to deal with this is to first adopt the FTC Staff Summary, and then make any changes after notice and comment rulemaking or guidance (such as the suggestion below regarding time frames for pre-adverse action notices for employment use of consumer reports).

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⁸ FTC, 40 Years Staff Report Accompanying FTC Staff Summary 10–11.

⁹ CFPB, “Joint User” Rule, CFPB Supervision and Examination Manual–Version 1.0.

Beyond these top priorities, the Bureau should also revise other provisions in the inherited regulations in the following manner (in no particular order).

5. Require Mortgage Creditors to Pay All Closing Costs as Overhead.

The disclosure requirements under RESPA and TILA could be greatly streamlined if creditors were required to pay all closing costs themselves, as overhead. Creditors could still pass those costs along to consumers but only as part of the interest rate. They would not be allowed to separately charge a laundry list of itemized closing costs. As a result, it would be much easier for creditors to calculate the APR on credit. The only finance charges would be interest, so there would no longer be a difference between the APR on open and closed-end real-estate secured credit. Good faith estimates and settlement statements would be much shorter and easier to prepare. This would also benefit consumers because shopping for credit would be much easier. This proposal would eliminate the problem of information overload created by confusing lists of closing costs that often cannot be compared among credit offers.

6. Eliminate Exceptions to Consumer Protection Rules.

The fewer exceptions and subcategories that a regulation has, the easier it is for creditors to comply with it, regulators to enforce it, courts to interpret it, and consumers to understand it. Qualifying a rule with exceptions, special rules, and subcategories leaves openings for creditors to exploit. Creditors may complicate the structure of their products to fall within an exception, and gradually the exception becomes the rule, often necessitating a rewrite of the regulation. Limiting the scope of a rule so that it does not apply to the entire marketplace also creates compliance risk for creditors, as it requires them to have systems for identifying the segment of the marketplace where the rule applies, and to make sure that they follow it in that segment.

For example, at present the Truth in Lending Act and regulations prohibit a home improvement lender from paying the home improvement contractor directly, without getting the consumer's signature or going through escrow—but only for loans that qualify as HOEPA loans.¹⁰ Extending this protection to the entire marketplace would simplify the regulatory scheme. At the same time, it would help consumers, lenders, and the secondary market, as it ensures that home improvement work is actually done and actually increases the value of the collateral that the lender is relying on. The only lenders it does not help are those that are involved with property flipping schemes or fraudulent home improvement contractors.

This is just one example of the benefits of applying existing rules to the entire marketplace.

7. Clarify Language in Regulation Z That Has Led to Costly and Unproductive Litigation About Whether Truth in Lending Claims Should Be Filed in State or Federal Court.

The Truth in Lending Act allows states to seek an exemption from TILA's disclosure requirements if they adopt substantially similar requirements.¹¹ The Federal Reserve Board

¹⁰ Reg. Z § 1026.34(a)(1).

¹¹ 15 U.S.C. § 1610(a)(2).

granted five states exemptions under this provision.¹² When it did so, however, its language was unclear about whether violations were actionable as violations of the federal statute, in which case federal courts would have jurisdiction, or only as violations of the comparable state statute. In 2005, noting that the question “raises very difficult issues of regulatory and statutory construction,” and that “the Federal Reserve regulations lack clarity,” the First Circuit left most of the issues unresolved.¹³

Unresolved jurisdictional questions like this clog the courts and make it harder for parties to obtain decisions on the merits of their claims. The Bureau could easily end this unnecessary, time-consuming, and costly litigation by clarifying the language of Regulation Z to indicate concurrent jurisdiction.

8. Make It Even Clearer That a Consumer Who Rescinds a Transaction Under TILA Need Not First Tender the Loan Proceeds.

The right to rescind a home-secured credit transaction is perhaps the most important consumer protection in the Truth in Lending Act. Creditors have sought to undercut this right by refusing to implement rescission until the consumer tenders the proceeds of the loan. Because the consumer must almost always refinance the home in order to obtain the tender amount, and because the home cannot be refinanced while it is subject to the original creditor’s security interest, requiring tender as a precondition of rescission makes the rescission right meaningless.

In 2003, in *Yamamoto v. Bank of New York*, 329 F.3d 1167 (9th Cir. 2003), the Ninth Circuit held that courts can not only condition rescission upon tender, but can also require the consumer to prove the ability to tender before the court even determines whether the consumer has a right to rescind. Lower courts have jumped on this ruling as a docket control device that bars the courthouse door to consumers seeking to rescind the abusive loans that fueled the subprime mortgage meltdown. The result is a vast amount of factual development and litigation on a purely speculative question—whether the consumer will have, at some future time, the ability to raise a sum of money that has not yet been determined and that will depend on the removal of a lien that currently exists. This obstacle prevents consumers from obtaining rulings on the substance of their claims.

After the *Yamamoto* decision was announced, the Federal Reserve Board staff issued a commentary provision that clarified that a consumer is entitled to an opportunity to establish a rescission claim in court before the question of tendering the proceeds is addressed.¹⁴ However, the commentary provision has not stopped the proliferation of rulings requiring the consumer to demonstrate ability to tender before the court will rule on the right to rescind. The Bureau should strengthen the commentary provision and incorporate it into the regulation itself. By doing so, the Bureau will clarify the law, streamline it, and reduce unnecessary litigation that obstructs enforcement of the right to rescind.

¹² Reg. Z § 1026.29; Official Commentary § 1026.29.

¹³ *Belini v. Washington Mut. Bank*, 412 F.3d 17, 26 (1st Cir. 2005).

¹⁴ Official Commentary § 1026.23(d)(4)-1.

9. Replace Erroneous References to “*primary*” in Regulation Z with “*principal*.”

TILA and Regulation Z establish certain disclosure requirements and substantive protections for extensions of credit that are secured by a consumer’s “principal dwelling.”¹⁵ Throughout TILA and Regulation Z, the text uses the word “principal” when describing a dwelling subject to TILA’s protections.¹⁶ The only exceptions in the entire Act and the Regulation appear in 15 U.S.C. § 1635(i)(1) and Reg. Z § 1026.40(f)(4)(iii) where the text uses the word “primary” instead of “principal” once each. In both instances this appears to be a drafting error. We recommend that the Bureau:

- a) replace “primary” with “principal” in § 1026.40(f)(4)(iii); and
- b) adopt an official interpretation specifying that the Bureau interprets § 1635(i)(1) as referring to “principal” dwellings.

Section 1635 establishes the right of rescission. The text of § 1635 refers elsewhere to “principal” dwellings.¹⁷ Section 1026.40(f)(4)(iii) limits when creditors may terminate or demand the repayment of the balance due on open-end reverse mortgages. It says:

(f) *Limitations on home equity plans.* No creditor may, by contract or otherwise: . . . (4) For reverse mortgage transactions that are subject to § 1026.33, terminate a plan and demand repayment of the entire outstanding balance in advance of the original term except: . . . (iii) If the consumer ceases using the property securing the note as the *primary* dwelling[.]¹⁸

Examination of the clause containing the word “primary,” the rest of § 1026.40, and the Official Commentary to § 1026.40 suggest that the drafters intended the word “primary” to have the same meaning as “principal.” Therefore, changing the word to eliminate any ambiguity will not have any substantive impact on the regulation.

10. Adopt a Single, Standardized Definition of “business day” and “weekend or holiday” for Regulations X and Z That Uses the Generally Accepted Meaning of the Terms.

Currently RESPA’s Regulations X and TILA’s Regulation Z define “business day” in three different ways:

1. “*Business day* means a day on which the [creditor’s offices] / [offices of the business entity]¹⁹ are open to the public for carrying on substantially all of its business functions.” 12 C.F.R. § 1026.2(6); 12 C.F.R. § 1024.2.

¹⁵ See, e.g., 15 U.S.C. § 1635(a); Reg. Z § 1026.23(a)(1) (right to rescind security interest in consumer’s “principal dwelling”).

¹⁶ *Id.* See also Reg. Z, Official Commentary § 1026.2(a)(24)-3 (“A consumer can have only *one* principal dwelling at a time. Thus, a vacation or other second home would not be a principal dwelling.”) (emphasis in original).

¹⁷ 15 U.S.C. § 1635(a) and (i)(2).

¹⁸ Emphasis added.

¹⁹ Regulation Z refers to the “creditor’s offices” and Regulation X refers to the “offices of the business entity.”

2. “[F]or purposes of rescission under §§ 1026.15 and 1026.23, and for purposes of §§ 1026.19(a)(1)(ii), 1026.19(a)(2), 1026.31, and 1026.46(d)(4), the term means all calendar days except Sundays and the legal public holidays specified in 5 U.S.C. 6103(a), such as New Year’s Day, the Birthday of Martin Luther King, Jr., Washington’s Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day.” 12 C.F.R. § 1026.2(6)
3. “[T]he ‘next business day’ means the next day on which the creditor accepts or receives payments by mail.” 12 C.F.R. § 1026.10(d) (1).

Using three different definitions for the same term in related transactions is a recipe for confusion and error. Even worse, all three of these definitions deviate from the commonly accepted meaning of the term “business day” in the United States.

The first and third definitions are subjective, will vary by entity, and can be changed without warning. Determining whether any given day qualifies as a “business day” under the first and third definitions requires inside knowledge of how a given business operates—knowledge that the typical consumer is unlikely to have.²⁰ The second definition is confusing and flawed because it includes Saturday as a business day—contrary to how laymen commonly use the term “business day.” As a federal District Court judge observed “it would likely surprise the average person (it certainly surprised this judge) to learn that ‘Saturday’ is included within TILA’s definition of a ‘business day.’ ”²¹

The Bureau should replace all of these definitions with a single, standardized definition that follows the generally understood meaning of the term. Specifically, “business day” should be defined as: “every calendar day except Saturday, Sunday, or the legal public holidays specified in 5 U.S.C. 6103(a).”

As noted above, this definition should apply for purposes of Reg. Z § 1026.10(d)(1), which determines when is the “next business day” if the consumer’s credit card due date is extended under 15 U.S.C. § 1637(o)(2) because the due date falls on a date that “the creditor does not receive or accept payments by mail (including weekends and holidays).” In addition, the Bureau should simplify this CARD Act prohibition to provide that if the due date is a day that is NOT a business day, then any payment received on the next business day cannot be treated as late.

With the enactment of the Credit CARD Act, many consumers now assume that if their due date falls on a weekend or holiday, they actually have until the next day. Yet some credit card companies avoid this rule by claiming that, because they retrieve their mail even on Sundays and holidays, they can impose a late fee if a payment is due on a Sunday and not received until Monday. They impose late fees even if the consumer’s payment was in fact delayed due to the Sunday or holiday because, for example, electronic payments were not processed over the holiday. A straightforward business day rule that applies equally to all is much simpler from a compliance perspective, levels the playing field, and makes more sense than requiring consumers

²⁰ See Official Commentary to Reg. Z § 1026.2(a)(6)-1.

²¹ *Aubin v. Residential Funding Co., L.L.C.*, 565 F. Supp. 2d 392, 397 (D. Conn. 2008).

to know the intricacies of whether a creditor actually accepts mail on a Saturday or Sunday or processes payments.

These changes will simplify compliance and training for businesses and will reduce the possibility of errors and litigation that arise from confusion over whether a particular day qualifies as a business day. While the change will also affect the duration of time periods described in the regulations affected (most likely by extending them by one day), the change will not have a significant impact and any detriment will be out-weighed by the benefits.

11. Clear Up Other Inconsistencies in the Truth in Lending Regulations.

There are a number of other ways that Regulation Z can be streamlined and improved, simply by eliminating inconsistencies and archaic provisions. For example, home equity lines of credit were formerly regulated jointly with other open-end credit. A separate section of Regulation Z now applies to home equity lines of credit, but it contains a number of provisions that are left over from the former joint regulation. Eliminating these archaic provisions would reduce confusion and ease compliance and enforcement.

12. The Bureau Should Set a Time Frame for Pre-Adverse Action Notices for Employment Uses of Consumer Reports.

Another measure that the Bureau could take to ensure clarity in consumer reporting is to initiate a notice and comment rulemaking setting a firm time period between when a pre-adverse action disclosure is sent, and when an employer may take the adverse action. This time frame should be 30 days so that, if the worker finds an error in the report, he or she has time to correct it.

Section 604(b)(3)(A) of the FCRA, 15 U.S.C. § 1681b(b)(3)(A), requires that, before an employer can take an adverse action based on a consumer report, the employer must send a copy of the actual report and the Summary of Rights to the worker, also known as the “pre-adverse action” disclosure. However, the FCRA does not set forth a definitive amount of time between the pre-adverse action disclosure and the adverse action.

Currently, the FTC Staff Summary provides that there be a “reasonable time” between the pre-adverse action disclosure and the adverse action.²² Previously, an FTC Staff Opinion provided that the employer must send the pre-adverse action notice five (5) days prior to taking the adverse action.²³ Neither of these options is adequate to protect workers, especially those harmed by an error or inaccuracy in a consumer report.

If there is an error in a consumer report, five (5) days is simply not sufficient for an employee to correct. As the Bureau knows, a consumer reporting agency has a full 30 days to correct an error in a consumer report—twenty-five days past the five days that an employer could take the adverse action. And a “reasonable” time frame is no better for workers, as it still does not provide enough time for workers to have errors corrected. For example, the court in *Johnson v.*

²² FTC Staff Summary § 604(b)(3) item 5, at 52.

²³ Weisberg, FTC Informal Staff Opinion Letter (June 27, 1997).

ADP Screening held that 14 days would meet a “reasonable” standard, even though the consumer did not have time to fix the error in that time frame.²⁴

We recommend the Bureau set a clear, bright-line 35-day time period between the pre-adverse action notice and the adverse action. With 35 days, the consumer will have five days to discover the error and request its correction, and the background check agency will have 30 days to it, so it will be possible to correct the error before the employer can take the adverse action based on the erroneous report. That is simplest, clearest, most logical and fairest course of action.

13. The Bureau Should Eliminate the Credit Score Disclosure Exceptions to the Risk-Based Pricing Rule.

Under the FCRA, a creditor must send a risk-based pricing notice whenever, based on a consumer report (including a credit score), the creditor provides credit on terms that are materially less favorable than the most favorable material terms available to a substantial proportion of consumers. However, two currently existing exceptions to this risk-based pricing notice do not make sense in light of the Dodd-Frank Act, and threaten to be the proverbial exception that swallows the rule. These exceptions also confuse consumers and should be eliminated.

When the FTC and Federal Reserve Board first issued regulations implementing this risk-based pricing notice in January 2010, they created exceptions in which a creditor is not required to provide a risk-based pricing notice if either: (1) the loan is secured by residential real property and the creditor provides a mortgage score disclosure to the consumer; or (2) the creditor provides every consumer with a copy of her credit score. 12 C.F.R. § 1022.74(d) and (e). At the time, the FTC and Board stated that these exceptions would benefit consumers, because they would “provide[] a consumer with specific information about his or her own credit history that will likely be more effective than the more generic information about consumer reports that will be included in a risk-based pricing notice.”²⁵

Subsequently, in July 2010, Congress passed the Dodd-Frank Act. Section 1110F of that Act amended the risk-based pricing notice requirement by requiring that, if the credit decision is based on a credit score, the creditor must provide the credit score that it actually used in the risk-based pricing notice.

When the FTC and FRB issued regulations to implement the Dodd-Frank score disclosure requirement, they deliberately chose to keep the pre-existing credit score disclosure exceptions, despite the fact these exceptions no longer made sense. The exceptions threaten to gut the risk-based pricing notice requirement because, since the new Dodd-Frank disclosure requires these notices to disclose the credit score used by the creditor anyway, it is much simpler for creditors to just disclose credit scores to all consumers who apply for credit. Disclosing credit scores to all applicants avoids the task of determining which consumers must be provided the risk-based pricing notice. The result is that many consumers who would benefit from a risk-based pricing notice do not receive the notice, contrary to Congress’s intent in enacting that requirement.

²⁴ *Johnson v. ADP Screening and Selection Services, Inc.*, 768 F. Supp. 2d 979 (D. Minn. 2011).

²⁵ 73 Fed. Reg. 28,966, 28,983 (May 19, 2008).

Prior to the Dodd-Frank Act, the fact that creditors could choose the credit score disclosure exception was justifiable in that consumers would be receiving a benefit—a free credit score—in lieu of the risk-based pricing notice. Indeed, the FTC and Board specifically cited this benefit as the reason for allowing the exception.²⁶ However, with the addition of Dodd-Frank’s credit score disclosure requirement, there is no longer any such tangible benefit to consumers who were subject to risk-based pricing. The exceptions should be removed, as they no longer meet the legal standard under Section 615(h)(6)(iii) of the FCRA, 15 U.S.C. § 1681m(h)(6)(iii), because they no longer represent classes of transactions for which the risk-based pricing notice will not significantly benefit consumers.

The problems with the pre-existing credit score disclosure exceptions are exacerbated by the fact that they do not require the disclosure of the credit score used by the creditor, but permit disclosure of a generic score. The mortgage score disclosure exception only requires disclosure of “[t]he information required to be disclosed to the consumer pursuant to section 609(g) of the FCRA.” 12 C.F.R. § 1022.74(d)(1)(ii)(D). Section 609(g) of the FCRA in turn permits disclosure of a generic credit score, at paragraph (1)(C). Similarly, the non-mortgage score disclosure exception only requires disclosure of the “current credit score of the consumer or the most recent credit score of the consumer that was previously calculated by the consumer reporting agency for a purpose related to the extension of credit.” 12 C.F.R. § 1022.74(e)(1)(ii)(D).

These provisions create a serious loophole to the Dodd-Frank credit score disclosure, which requires disclosure of the actual credit score “used by such person in making the credit decision”. 15 U.S.C. § 1681m(h)(5)(E). A creditor that engages in risk-based pricing could avoid sending the risk-based pricing notice, instead sending a notice pursuant to the pre-existing exceptions that only discloses a generic score. This notice would not disclose the actual credit score upon which the creditor relies, and yet the creditor would be in compliance with the regulation. This contravenes both the letter and intent of Section 1100F of the Dodd-Frank Act, which was specifically written to require disclosure of the actual score used by the creditor.

From the Supplementary Information, it appears the FTC and Board did not remove the pre-existing credit score disclosure exceptions in part because of the transfer of authority over the FCRA to the Bureau. The FTC and Board noted that:

Eliminating the credit score disclosure exception notice would fundamentally change the structure of the risk-based pricing rules and may substantially affect compliance costs. Given that rulemaking authority will be transferred to the Bureau on July 21, 2011, the Agencies do not believe that it is appropriate to make a substantial and fundamental change to the rules at this time.

²⁶ The FTC and Board stated: The credit score disclosure provides tangible value to consumers because free credit scores typically are not available to consumers in connection with non-mortgage transactions. Consumer reporting agencies and other sellers of credit scores typically charge consumers between \$6 and \$10 for a credit score. 73 Fed. Reg. 28,966, 28,983 (May 19, 2008).

Now that the transfer of authority has taken place and the Bureau has the power to write rules under the FCRA, we strongly recommend that the exceptions to the risk-based pricing notice for credit score disclosures be removed.

14. The Bureau Should Eliminate the Confusing Exception for Deferred Interest Plans.

The Bureau can and should reduce consumer confusion and incentives for complicated and unfair credit terms by eliminating the exceptions for deferred interest plans in the Official Commentary §§ 1026.55(b)(1)-3.i and 1026.54(a)(1)-2.i. *See also* 12 C.F.R. § 1026.16(h). These exceptions were established by the Federal Reserve Board in its regulations implementing the Credit CARD Act. Consumer groups had opposed the exception based on the inherently confusing nature and deceptiveness of plans that promote “no interest” or “0% interest,” but in reality accrue interest starting from the purchase date and impose this interest retroactively if consumers do not pay off the entire purchase balance by the end of the promotional period.

Even with improved disclosures, many consumers have trouble understanding the inherently complex structure of deferred interest plans. Other consumers miscalculate the end of the promotional period, or expect to be able to pay the balance in full but for a variety of reasons find that they cannot. Indeed, the only reason that creditors make deferred interest offers instead of a promotional rate offer (that does not kick in retroactively) is to trap a certain percentage of consumers. In any of these circumstances, the consumer is hit with an enormous, retroactive application of interest that causes significant injury, is unexpected and unavoidable, and is not outweighed by the creditors’ desire to profit from these tricks and traps.

Furthermore, we believe that Section 127(j) of TILA’s prohibition against double cycle billing, as added by the Credit CARD Act, prohibits deferred interest plans. Section 127(j) of TILA provides that a finance charge cannot be assessed as a result of the loss of any time period within which the consumer may repay a balance without incurring a finance charge based on any balances from prior billing cycles. This language specifically prohibits deferred retroactive interest plans, which impose a finance charge based on balances from prior billing cycles if the consumer does not repay the entire balance within the specified time period. Section 127(j) does not contain an exception for deferred interest plans; in fact, such an exception was included in a prior version of the bill. Its removal from the final version enacted into law reflects Congress’s determination that deferred retroactive interest plans are prohibited by Section 127(j).

Thus, in order to reduce consumer confusion and to avoid deception, the Bureau should eliminate the deferred interest plan exception to the Credit CARD Act.

15. The Bureau Should Eliminate the Exception for Convenience Checks.

The Bureau should eliminate the exception for convenience checks from the unauthorized use protections of the Truth in Lending Act. This exception was established by the Federal Reserve Board in 2008 in the Official Commentary § 1026.12(b)-4.

The Board justified this decision based on its believe that “it was unnecessary to extend the unauthorized use protections to convenience checks because convenience check transactions are generally subject to the Uniform Commercial Code (UCC) provisions governing checks, and thus a consumer generally would not have any liability for a forged check ...”²⁷ However, the UCC permits banks to hold consumers partially liable for unauthorized use under a comparative negligence standard.²⁸ Thus, TILA’s unauthorized use protections provide far stronger protections for consumers than does the UCC.

Furthermore, the convenience check is merely a mechanism for initiating a credit card transaction, like a telephone or computer. Even though neither a telephone nor a computer is a credit card, purchases made by telephone or Internet are both covered by the unauthorized use protections. It seems anomalous that if a thief uses only the credit card number, without more, the unauthorized use protection applies, but the simple fact that the number is on a check takes the transaction outside this protection.

A recent complaint received by NCLC, a copy of which is appended as Attachment 1, demonstrates why convenience checks should be regulated as credit cards under TILA. Ms. X, a victim of domestic violence, fled the marital home on September 9, 2011 and obtained a protective order. Subsequently, her abusive husband intercepted two convenience checks and used them to charge \$7,000 to two of Ms. X’s individual credit card accounts. The card issuers, Chase and Bank of America, are refusing to treat this theft as unauthorized use, despite the fact that Ms. X even had a protective order against Mr. X on the date of the charge showing that Ms. X was not in the marital home at the time.

Unfortunately, Chase and Bank of America are not required to treat this theft as unauthorized use because of the exception for convenience checks. This legal loophole was confusing to even an attorney representing Ms. X; thus, an average consumer would be even less likely to understand that a convenience check is exempted from the unauthorized use protections of TILA. To prevent consumer confusion and ensure uniform protections for all devices accessing a credit card account, the Bureau should eliminate this exception.

16. The Bureau Should Eliminate the EFTA Exception For Payments that Originate By Check and Should Ban Remotely Created Checks.

The protections of the EFTA only apply to “electronic fund transfers,” which is defined to exclude electronic transfers that “originated by check, draft or similar paper instrument.” Yet in this increasingly electronic world, most transfers are processed electronically. Checks may be converted to EFTs, which are covered by the EFTA, or processed as checks, which are not. Some companies, including payday lenders, exploit the EFTA loopholes by changing payments from check to electronic form and back again. Some payment processors even offer to help process payments in a form that is explicitly designed to avoid the EFTA.

Similarly, payday lenders and others avoid the EFTA by creating remotely created checks or, the newest variation, remotely created payment orders, such as those recently targeted by the FTC.

²⁷ 72 Fed. Reg. 32,948, 32,959 (June 14, 2007).

²⁸ U.C.C. § 3-406.

The National Association of Attorneys General has long called for the elimination of remotely created checks, which are often used in scams and frauds.²⁹ With the widespread use of electronic payments and the growth of the ACH system, there is simply no longer any legitimate need for remotely created checks or payment orders.

No matter how they make a payment, consumers have no way of knowing whether it will be covered by the protections of the EFTA or not. They have no control over the matter and cannot possibly know what happens after they make a payment.

Businesses that are not trying to exploit loopholes, like major grocery stores, have no trouble complying with the EFTA even though they could avoid turning checks into EFTs and stay under weaker UCC protections. The Bureau should streamline regulations, simplify the rules that apply to payments, create a level playing field and enhance consumer protection by treating all electronic payments as EFTs and banning remotely created checks and payment orders.

II. THE BUREAU SHOULD NOT ROLL BACK CRITICAL CONSUMER PROTECTIONS IN THE NAME OF STREAMLINING.

In its *Federal Register* notice, the Bureau gave examples of possible ways to streamline inherited regulations. Many of these ideas would amount to rolling back critical consumer protections and should not be adopted.

1. The Bureau Should Not Define the Terms “Consumer” or “Credit” in a Manner That Would Narrow the Scope of Consumer Protection Statutes.

The Bureau asks whether the definitions of “consumer” and “credit” should be made consistent across the regulations under several different consumer statutes. We urge the Bureau to proceed cautiously in this area. In particular, some of the consumer protection statutes listed are broader in scope than others. The Bureau should not cut back on the scope of consumer protection statutes in the name of streamlining.

a. Consumer

The definition of “consumer” must necessarily differ between various consumer protection statutes, because it serves different purposes for each Act. Indeed, the various statutes themselves define “consumer” differently. For example, Regulation E and the Electronic Funds Transfer Act (EFTA) itself define consumer broadly as a natural person. Similarly, Regulation V and the Fair Credit Reporting Act (FCRA) define “consumer” broadly as an individual.

For Regulation Z, the definition of “consumer” is narrower. It is limited to the person to whom credit is extended, except for rescission rights. This definition is similar to and relies upon the definition in the Truth in Lending Act (TILA), which establishes TILA’s limitation of coverage to the person to whom credit is extended (with certain exceptions). Obviously, the definitions in the EFTA and FCRA do not incorporate this element because they do not exclusively pertain to

²⁹ See attachment 2, Nat’l Ass’n of Attorneys General Letter to the Board of Governors of the Federal Reserve System, May 3, 2005.

credit extensions. Also, while Regulation Z's definition is mostly limited to natural persons, it extends to all credit cardholders, even non-natural persons, because some of TILA's credit card protections apply to businesses. This is not true for EFTA or the FCRA.

Thus, we do not believe that the definition of "consumer" should be amended to be the same for all consumer protection regulations. However, if the Bureau intends to make the definition consistent, the only definition that appears to make sense for all of the statutes is the broad, expansive definition of consumer as a natural person or individual.

b. Credit

As with the term "consumer," the term "credit" under Regulation Z and Regulation B must necessarily be different because the two regulations serve different purposes, and the statutes themselves define the term differently. Regulation Z and TILA define credit as the right to:

- defer payment of debt; or
- to incur debt and defer its payment.

Regulation B and the Equal Credit Opportunity Act (ECOA) use essentially the same definition, but then add another prong. This third prong defines credit as the right to:

- purchase property or services and defer payment therefor.

This third prong in the ECOA covers situations in which the consumer is permitted to obtain goods or services first and pay for them later, such as medical treatment or cell phone services. This third prong was included in the original definition of credit when the ECOA was enacted in 1974. *See* Pub. L. No. 93-495 (October 28, 1974). Eliminating it would significantly change the scope of the ECOA, and deprive consumers of protection against discrimination in several significant types of transactions.

Eliminating the third prong of the ECOA definition would deprive consumers of protection against discrimination in several significant types of transactions. For example, the ECOA protects consumers against discrimination when they seek medical treatment without paying for it ahead of time; when their landline or cellular telephone plan provides for payment after the fact, or when they obtain home improvements or home repairs and are billed later.

The ECOA is broader than TILA in other very significant ways. TILA effectively narrows its definition of "credit" through a restrictive definition of "creditor." First, the TILA definition of "creditor" excludes non-consumer transactions. 15 U.S.C. § 1602(g). Importing this restriction into the ECOA would legalize discrimination against small businesses based on the race or gender of the business owner. In addition, to meet the TILA definition of "creditor," an entity must engage in transactions that include a finance charge or are payable in more than four installments. This rigid and artificial requirement provides a way for creditors to evade TILA and undermines the purposes of the law. It would make even less sense in the context of the ECOA, which does not deal with disclosure of finance charges and payment schedules.

Narrowing the ECOA definition would also be a major change to an interpretation that has existed for decades. The Federal Reserve Board notes “Regulation B covers a wider range of credit transactions than Regulation Z (Truth in Lending).” Official Staff Commentary to Regulation B § 202.2(j). The Board has taken this position, and this language has been part of the Official Staff Commentary, since at least 1985. See 50 Fed. Reg. 48,018 (Nov. 20, 1985). Changing this position, and narrowing the scope of the ECOA, would be a significant change that should not be taken lightly as part of any “streamlining.”

Most importantly, narrowing the scope of coverage of Regulation B would be a significant setback to the goal of ending discrimination in credit transactions. It would, for example, signal to providers that they could require persons of one ethnicity to pay cash for medical care, while allowing others to pay over time. The Bureau should not roll back protections against credit discrimination, whether in the name of streamlining or otherwise.

2. The Bureau Should Continue to Require Financial Services Providers to Provide Annual Privacy Notices to Their Customers.

Regulation P of the Board of Governors of the Federal Reserve System and parallel regulations of other Federal agencies govern the treatment of nonpublic personal information about consumers. These regulations generally require that financial services providers give a privacy notice to a customer annually during a customer relationship. Providers have questioned the value of providing consumers annual notices where the provider's privacy practices have not changed since the last notice, at least where the provider does not share information with other firms (or shares in narrow cases). Should there be an exception from the requirement to provide an annual privacy notice in these or any other circumstances?

The Bureau should continue to require that financial services providers give privacy notices to their customers annually. Even though a provider's privacy practices may not have changed since its previous notice, the customer's circumstances may have changed, and the notice reminds the customer of his or her ability to opt out of certain disclosures in light of any developments that may have occurred in the interim. Furthermore, putting the burden on customers of remembering each provider's privacy policy over a long span of time is unreasonable, especially given that a customer may have several such providers. Customers are unlikely to have retained years-old notices, and a new notice provides instant access to the necessary contact information should the customer have decided to exercise his or her opt out rights. Without the requirement of a renewed notice each year, several years—even decades—could lapse without any reminder to the customer of the provider's use of his or her personal information. Only where the provider's policy is to not share its customer's information with any non-affiliated third party should the provider be able to cease providing annual privacy notices.

3. The Bureau Should Continue to Require Financial Services Providers to Post a Sign on an ATMs Informing Customers That a Fee May Be Imposed But Could Issue Regulations to Implement the Statutory Defense to Liability.

The Bureau has asked whether it should eliminate the requirement for ATM operators to post a sign regarding their imposition of fees for ATM services. 15 U.S.C. § 1693b(d)(3). The Bureau

should not eliminate the requirement to post a sign on an ATM that a fee may be imposed as it is explicitly and unequivocally required by the Electronic Funds Transfer Act. The posted sign near the ATM is the first and most readily visible information about the fee that a consumer sees. The ATM sign tells consumers about two possible fees, one by the ATM operator and one by the consumer's financial institution. If the ATM does not charge a fee because it is a network ATM, then there will be no on screen notice even if the consumer's financial institution charges a fee. Without a posted sign, the consumer would have to engage in the transaction before knowing the fee. There is simply no good reason for the requirement for the sign to be eliminated. Other disclosures about the fee—i.e., those that appear on the screen in the midst of the transaction, and on the receipt—are also necessary and good, but will not replace the need for the posted sign.

Additionally, under the EFTA, ATM operators have a statutory defense if they do post a sign in compliance and the sign is subsequently removed or damaged. 15 U.S.C. § 1693(h)d. We would not oppose an attempt by the Bureau to establish rules to implement this defense. For example, the Bureau could propose a rule that a financial institution is in compliance if it has reasonable procedures in place to observe that signs are present (the Bureau could also define what are reasonable procedures) and to replace a missing sign within 3 days of notice.

4. The Bureau Should Not Impose Data Collection Exemptions Which Would Weaken the Effectiveness of Consumer Protection Regulations.

The Bureau asks whether Regulations B (under the Equal Credit Opportunity Act) and Regulation C (under the Home Mortgage Disclosure Act) should have a consistent exemption for data collection and whether creditors that receive a small number of applications should be exempt from Regulation B adverse action notice requirements. We urge the Bureau not to adopt these exemptions because they would weaken the effectiveness of Regulation B.

ECOA and HMDA serve different purposes. HMDA and Regulation C exempt smaller financial institutions which do not conduct business within a metropolitan statistical area or have any federal connection from data collection and disclosure requirements.³⁰ The data requirements of ECOA and Regulation B further ECOA's ban against discrimination by any creditor. Congress chose not to exempt smaller financial institutions from Regulation B data collection requirements. Instead, Regulation B broadly applies to all creditors who receive applications for credit where the application primarily concerns the purchase or refinancing of a dwelling to be used by the applicant as a principal residence.³¹ If the Bureau applied the same data collection exemptions to Regulations B and C, data concerning small lenders presently captured for ECOA monitoring purposes would be lost. The absence of this data would weaken the effectiveness of Regulation B and contravene its purpose of promoting the availability of credit to all creditworthy applicants on a non-discriminatory basis.³² Regulation B's data requirements are the cornerstone of fair lending enforcement; without data there can be no assurance of compliance. Therefore, we urge the Bureau not to narrow the scope of Regulation B by exempting small lenders from data collection requirements.

³⁰ 12 C.F.R. § 203.4(a).

³¹ 12 C.F.R. § 202.13(a).

³² 12 C.F.R. § 202.1.

Moreover, small volume lenders should not be fully exempted from Regulation B's notice requirement. Regulation B currently exempts small-volume creditors from providing written adverse action notices to credit applicants by permitting oral notification.³³ However, Congress did not express an intent to exempt small volume lenders from providing any adverse action notice to credit applicants. Indeed, Congress's specific direction on the method of notification makes clear that burden issues already were considered and that providing notice was considered and retained. Congress has not exempted small volume lenders from Regulation B adverse action notification requirements and we urge the Bureau not to exempt these lenders. Such an exemption would weaken Regulation B under the guise of streamlining.

For similar reasons, we oppose expanding exemptions to the data reporting requirements of Regulation C under the Home Mortgage Disclosure Act. HMDA data is a critical monitoring tool to prevent discrimination in the mortgage market. Depositories are already exempt if their assets are below a specified minimum or if they are not located in a metropolitan statistical area. Additional exemptions would interfere with the goals of broad fair lending enforcement.

5. The Bureau Should Not Narrow the Scope of the Truth in Lending Act, Which Would Leave a Particularly Abusive Set of Transactions Without Basic Consumer Protections.

The Bureau asks:

In general, Regulation Z covers a creditor if it extended consumer credit more than 25 times in the past calendar year (or more than 5 times, for transactions secured by a dwelling). 12 CFR 226.2(a)(17)(v). Should these thresholds be raised? What would be an appropriate threshold? And should a similar exemption be applied to disclosure requirements under the Real Estate Settlement Procedures Act that the Bureau will integrate with Truth in Lending disclosure requirements?

Regulation Z generally covers a creditor if it makes more than 25 consumer loans in total of any type. Should different types of consumer credit have different thresholds? For example, should creditors be exempted from the student loan requirements if they made less than a certain number of student loans in the preceding calendar year, regardless of how many other consumer loans they made?

76 Fed. Reg. 75825, 75,828 (Dec. 5, 2011).

These proposals would foster consumer fraud. Moreover, they would increase the complexity of the Truth in Lending regulations, create more exceptions, and reduce uniformity. Instead, the Bureau should streamline the rules regarding the scope of the Truth in Lending regulations by making them simpler and more broadly applicable.

It is particularly important not to widen the loopholes in TILA coverage because of the potential for exploitation by small-time property flippers and predatory lenders. The existing rules already

³³ 12 C.F.R. § 202.9(d).

allow too much scope for evasion. For example, a property flipper in the East St. Louis area had perhaps a dozen mini-corporations through which he did business. For years he failed to comply with TILA. When challenged, he claimed that none of the mini-corporations made more than five home-secured credit transactions per year, so he could continue his property-flipping business without disclosure. Similarly, a property flipper in Baltimore, Maryland, sought to evade TILA by staying under the numerical thresholds. He set up dummy corporations in family members' names, each of which made fewer than five home-secured loans per year. We have seen similar patterns throughout the country. Large institutional lenders are unlikely to find it worthwhile to adopt these ploys, but fringe lenders who target poor neighborhoods or vulnerable individuals for abusive credit products can be expected to do so. Foreclosure rescue scammers are also typically small-time operators who would benefit greatly in their ability to commit fraud if the TILA numerical thresholds were raised.

Maintaining or broadening TILA's coverage is particularly important since TILA is now much more than a disclosure statute. With the Dodd-Frank Act amendments, it is the primary source of prohibitions against appraisal fraud, lending without regard to repayment ability, and a host of other fundamental substantive protections. Narrowing the scope of these essential protections would foster abusive lending.

To respond to the Bureau's specific questions, first, the 25-per-year and 5-per-year thresholds should *not* be raised. Instead, they should be harmonized with the numerical threshold for home-secured loans. For both types of loans, the threshold should be five credit transactions. Complexities arise under the current rule when a creditor mixes-and-matches home-secured and non-home-secured transactions. For example, if a creditor makes six home-secured credit transactions in a year, and ten that are not secured by the home, does TILA apply to the ten transactions that are not home-secured? Eliminating the distinction between the two thresholds in this way will reduce these complexities and make compliance simpler.

Second, the Bureau asks whether a numerical threshold similar to that in TILA should be imported into the Real Estate Settlement Procedures Act (RESPA). The Bureau notes its ongoing effort to integrate the disclosures required under TILA with the uniform settlement statement required by RESPA. This proposal is impractical and would result in unnecessary complexity. RESPA has its own statutory coverage requirements: the uniform settlement must be used only in the case of a "federally related mortgage loan,"³⁴ a term that the statute carefully defines (and that results, practically, in far less coverage than under TILA). Adding TILA's numerical thresholds on top of this restriction would add an unnecessary second layer of complexity.

Third, the Bureau asks whether it should set different numerical thresholds for different types of credit transactions. Doing so would make the rule more complex rather than streamline it. Indeed, it is puzzling that the board has even suggested that adding extra layers of complexity would "streamline" a rule. Moreover, allowing creditors to diversify their lending in order to evade TILA coverage only encourages abusive practices by fringe lenders.

³⁴ 12 U.S.C. § 2603.

6. The Bureau Should Not Reverse the FRB's Decision that a Credit Card Issuer Should Consider the Income of Only Those Consumers Liable on an Account.

Just last year, the Federal Reserve Board amended Regulation Z to require that a card issuer must consider the consumer's independent ability to pay when deciding whether to issue a credit card. In particular, the Staff Commentary clarified, that as a general matter, an issuer cannot rely solely on household income to consider ability-to-repay. However, a card issuer is permitted to consider the income or assets of the consumer's spouse to the extent that the consumer has an ownership interest in it.

We supported these amendment to Regulation Z and accompanying changes to the Commentary, and we continue to support them. We have consistently taken the position that the ability-to-pay standard must be as meaningful and vigorous as possible. Thus, we strongly endorse the idea that the issuer must consider the ability-to-pay based solely on the income and assets of the consumer or consumers who are liable on the account. Considering the income of a non-obligated household member is contrary to the intent of the Credit CARD Act, given that improvident granting of credit was the very issue that the ability-to-pay provision was enacted to address.

We understand that issuers and some members of Congress have argued that the requirement to consider the consumer's independent ability-to-pay discriminates against women who are stay-at-home mothers. We do not believe that the requirement is discriminatory. As an initial matter, to the extent that a stay-at-home mother has a legal entitlement to a spouse's income, such as in a community property state or with a joint bank account, the Commentary provides that such income may be considered.

Furthermore, consideration of spousal income can actually harm consumers. If a stay-at-home mother incurs debt that she does not have ability to repay, and she cannot access the spouse's income or assets to repay the debt, she will be in a far worse position than if she had never incurred the debt. In addition, considering spousal income creates the negative incentive, that if the consumer defaults, the issuer will be encouraged to wrongfully pursue the non-liable spouse for repayment because the granting of credit was based on the spouse's income. This is already a problem that attorneys representing consumers report to us—issuers aggressively seeking payment from non-liable spouses.

It is important to note that the ability-to-pay provision does not single out stay-at-home mothers, and thus is in no way an example of disparate treatment for women. The same requirement applies to many other individuals who have limited individual income but could report higher household incomes. Such examples include adult children living with parents, unemployed siblings living with employed siblings, and stay-at-home fathers. The provision also applies if a consumer becomes unemployed and is married or has a domestic partner.

Indeed, the U.S. Bureau of Labor statistics has noted that of the 9.7 million families that include an unemployed family member, 67.7% also included an employed member.³⁵ Yet no one is

³⁵ U.S. Bureau of Labor Statistics, Employment Characteristics of Families—2010 (March 2011), *available at* <http://www.bls.gov/news.release/famee.nr0.htm>. It appears that the number of married unemployed consumers may

arguing that unemployed consumers are being discriminated against because they cannot obtain credit cards in their name alone based on their spouse or other family member's income. One might suspect that issuers are being strategically selective in focusing on stay-at-home mothers and not unemployed workers.

Finally, the Bureau should be cognizant that the true issue involves access to retail cards that are approved at point-of-sale, i.e., "instant credit." This is because, for general purpose cards that are not instant credit, the issuer can follow up or make a counteroffer to a stay-at-home parent or other applicant unable to qualify on his or her own income. But for instant credit, such follow up may not be possible at the point of sale, and the applicant might not want the card badly enough to follow through with her other options to qualify. Thus, the provision may slow down the instant credit approval process, which relies heavily on the "impulse buy" nature of the transaction. However, changing the provision in order to make instant credit cards easier to approve is exactly the wrong thing to do. It is contrary to and undermines the ability-to-repay requirement, whereas the current provision furthers and strengthens the requirement.

7. The Bureau Should Not Weaken the E-Sign Act Rules for When Written Disclosures May Be Delivered Electronically.

The Bureau should not permit certain disclosures now required to be in writing to be delivered in electronic form. These disclosures can already be delivered in electronic form, pursuant to E-Sign. All the creditor or provider need do to deliver the disclosure in electronic form is to ensure that the consumer actually agrees to electronic delivery and has the capacity to access information electronically, pursuant to the requirements of E-Sign's simple consent process. 15 U.S.C. § 7001(c).

The E-Sign consent process ensures that the consumer actually, affirmatively, consents to receive records in electronic form by (a) providing disclosures, (b) requiring the consumer to step through a simple online process to ensure that the consumer has the capacity to receive the electronic records in the form they will be delivered by the provider, (c) and ensuring the consumer has information about the consumer's right to withdraw consent to receive records electronically at any time.

Many consumers, especially those who are low-income or elderly, still do not have ready and reliable access to the Internet.³⁶ Allowing records to be delivered electronically would obviate the deliberate and careful consumer protections applicable to switching from paper to electronic records as required by E-Sign. Allowing the electronic delivery of records would be a disastrous change for consumers, and is completely unnecessary because the law already permits it.

8. The Bureau Should Not Permit Electronic Disclosures for Mobile Banking Without Careful Study and Full Consumer Protections.

be similar to the number of stay-at-home mothers, who number 5 million. U.S. Census Bureau, Mother's Day: May 8, 2011 (March 2011), at

http://www.census.gov/newsroom/releases/archives/facts_for_features_special_editions/cb11-ff07.html.

³⁶ FCC: Connecting America: The National Broadband Plan (March 2010), Ch. 9 Adoption and Utilization, Exhibit 9-A, at 167.

The Bureau has asked whether it should permit certain disclosures to be provided by text messaging in the context of mobile banking applications even though the messages do not meet the E-Sign Act requirement that they be readily retainable. The Bureau should not waive or alter legal requirements for mobile banking applications piecemeal without a full consideration of all of the issues and careful study of the most effective ways for consumers to actually see, understand and access all important information.

Especially in the context of mobile banking applications, where consumers often transact spontaneously in a setting where they are reading information on a tiny screen, it is essential for consumers to have full information and be encouraged to monitor their accounts. Access to paper confirmations or backup records may be especially important. Newer technologies may provide new opportunities to enhance consumer understanding, but not every technology is right for every consumer or every context.

The requirement in the E-Sign Act that a consumer must be able to retain an electronic notice before that notice can substitute for a paper one is a critical consumer protection. Consumers need the ability to keep records of important information. It is possible that text messages, coupled with emails, annual paper statements, or some other retainable record, could meet the spirit of the E-Sign Act. But the issue should be considered in the larger context of regulation of mobile banking and more research on the best methods of reaching consumers with the information they need.

III. CONCLUSION

Thank you for the opportunity to comment on ideas for streamlining regulations. We support the Bureau's effort to simplify regulations and compliance with those regulations as long as simplification enhances and does not undermine consumer protection. We believe there are many opportunities to simplify compliance for providers, level the playing field for good and bad industry actors, and protect consumers at the same time.

APA Asian Pacific American Legal Resource Center

LRC

December 20, 2011

Via Facsimile (888) 643-9624

Chase
PO BOX 1599
Wilmington, DE 19850-5299

RE:
Account Number Ending:

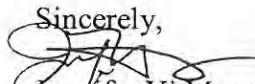
Dear Sir/Madam,

On behalf of Ms. [REDACTED] APALRC submits this letter in support of Ms. [REDACTED]'s fraud claim.

Ms. [REDACTED] filed a claim with Chase immediately when she found out about the unauthorized cash advance made on her credit card. Ms. [REDACTED] fled her home in New York with her two toddler children on September 9, 2011 because of the domestic violence. Ms. [REDACTED] obtained a temporary protective order on September 13, 2011 and a final protective order on September 21, 2011. The protective order is attached for your records. Subsequently, her abuser forged her signature and signed a check for \$3,000.

The Truth in Lending Act, 15 U.S.C. § 1602(o), defines an “‘unauthorized use’ as the use of a credit card by someone other than the cardholder who does not have actual, implied or apparent authority to use it...” Ms. [REDACTED] never authorized anyone to sign on her behalf. In fact, Ms. [REDACTED] was fearful of her life so she fled NY and filed for a protective order in Maryland. Ms. [REDACTED] did not sign the check, nor did she authorize anyone to sign on her behalf. Because of her abuser’s action, she continues to be victimized by him. Thus, we strongly believe that Ms. [REDACTED] should not be liable for the debt given the circumstances surrounding Ms. [REDACTED]’s case. Until this matter is resolved, no adverse report or action should be taken against Ms. [REDACTED]. See 15 U.S.C. § 1666(d); 12 C.F.R. § 226.13.

If you have any questions, you can contact me at (202) 706-7142 or by email at jennifer.cheung@apalrc.org. Thank you for your prompt attention to this matter.

Sincerely,

Jennifer Yi Man Cheung
Staff Attorney

D.C. Office: 1012 14th Street, NW, Suite 450, Washington, D.C. 20005 ♦ Helpline: 202.393.3572 Fax: 202.315.0375

Maryland Office: 11141 Georgia Avenue, Suite 215, Silver Spring, MD 20902 ♦ Phone: 301.942.2223

APALRC: Ensuring Access to Justice for Asian Pacific Americans since 1998

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APA Asian Pacific American Legal Resource Center

LRC

November 9, 2011

VIA CERTIFIED RETURN RECEIPT REQUESTED

Bank of America
PO BOX 15201
Wilmington, DE 19850

RE: _____

Account Number: _____

Dear Sir/Madam,

This office represents Ms. _____ in disputing an unauthorized charge to her Bank of America visa card.

Ms. _____ filed a claim with Bank of America immediately after she found out about the unauthorized cash advance made on her credit card. The cash advance was made by her estranged partner who forged her signature on her check. Despite the efforts of her and this office in explaining the circumstances surrounding the unauthorized cash advance, your bank representatives have refused to recognize it as a fraudulent transaction because the check was deposited into a joint banking account, to which Ms. _____'s partner – the person who forged her check to make the unauthorized cash advance – has unlimited access. We dispute Bank of America's decision.

Ms. _____ fled her home in New York with her two toddler children on September 9, 2011 because of domestic violence. Ms. _____ obtained a temporary protective order on September 13, 2011 and a final protective order on ~~September~~ ^{October} 21, 2011. The protective order is attached for your records. Subsequent to her fleeing from her New York home, her abuser forged her signature and signed a check for \$4,000. According to Bank of America's statement, this occurred on September 19, 2011. This check was subsequently deposited into a joint bank account but the entire sum was withdrawn almost immediately on September 21, 2011. By the time Ms. _____ knew about the unauthorized use, the money was already withdrawn.

The Truth in Lending Act, 15 U.S.C. § 1602(o), defines an “‘unauthorized use’ as the use of a credit card by someone other than the cardholder who does not have actual, implied or apparent authority to use it...” Ms. _____ never authorized anyone to sign on her behalf. In fact, Ms. _____ was in fear for her life so she fled New York and filed for a protective order in Maryland before this unauthorized use took place. Furthermore, the deposit of the cash obtained through this unauthorized cash advance into a joint bank account does not negate the unauthorized nature of the cash withdrawal. Ms. _____ never authorized anyone to make the cash advance nor did she permit the ill-gotten cash to be deposited into the joint bank account. The

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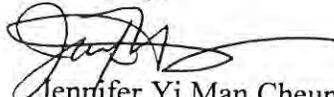
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entire transaction from the initial cash advance to the bank deposit and subsequent cash withdrawal was made without Ms. [redacted]'s knowledge or permission. The entire transaction is fraudulent. Ms. [redacted] did not authorize anyone to use her credit card. Ms. [redacted] did not sign the check, nor did she authorize anyone to sign on her behalf. Because of her abuser's action, she continues to be victimized by him. Because this transaction constitutes a fraudulent use as defined in the Truth in Lending Act, Bank of America should absolve Ms. [redacted] of any responsibility to pay for the cash advance, end and reverse any interests accumulated to the outstanding balance as a result of this cash advance. Thus, we strongly believe that Bank of America's decision is incorrect and not justified given the circumstances surrounding Ms. [redacted]'s case. Ms. [redacted]'s account should be properly credit with any fees or interest charge as a result of the unauthorized transaction. Until this matter is resolved, no adverse report or action should be taken against Ms. [redacted]. See 15 U.S.C. § 1666(d); 12 C.F.R. § 226.13.

If you have any questions, you can contact me at (202) 706-7142 or by email at jennifer.cheung@apalrc.org. Thank you for your prompt attention to this matter.

Sincerely,


Jennifer Yi Man Cheung
Staff Attorney*

Cc:

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NC1-002-29-01
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Attorney General of Georgia

IMMEDIATE PAST PRESIDENT
 BILL LOCKYER
Attorney General of California

May 3, 2005

Jennifer J. Johnson, Secretary
 Board of Governors of the Federal Reserve System
 20th Street and Constitution Avenue, N.W.
 Washington, DC 20551

Re: Docket No. R-1226 (Proposed Amendment to Regulation CC/
 Remotely Created Checks)

Dear Ms. Johnson:

We, the undersigned Attorneys General ("the Attorneys General"), submit the following comments to the Board of Governors of the Federal Reserve System ("the Board") in connection with the Board's pending proposal to amend Regulation CC with respect to demand drafts.¹ In brief, the Attorneys General take the position that demand drafts are frequently used to perpetrate fraud on consumers; that such drafts should be eliminated in favor of electronic funds transfers that can serve the same payment function; that if demand drafts are to continue to be used, the proposed originating-bank warranty of authorization should augment, not supplant, the existing receiving bank warranty; that demand drafts should be mandatorily marked as such; and that serious consideration should be given to extending the midnight deadline for returning unauthorized items to 60 days, as long as the ACH system is not adversely affected. Each of these points is discussed in turn below.

¹ Throughout these comments, unsigned paper drafts ostensibly bearing some statement reflecting drawer authorization (whether actually given or not) are referred to as "demand drafts," the term most commonly used by state law enforcement agencies. Such instruments are called "remotely created checks" in the Board's notice of proposed rulemaking.

1. Unauthorized demand drafts are often used to perpetrate fraud on consumers.

In recent years, fraudulent telemarketers and others engaged in consumer fraud have increasingly relied on bank debits to obtain money from consumers. The Federal Trade Commission (FTC) reports that 25 percent of all fraud complaints received by that agency in 2004 involved a bank debit—up 40 percent from the previous year.²

In late 2003, the National Automated Clearing House Association (“NACHA”) quoted its President as saying that “[m]any banks, as well as law enforcement and consumer protection agencies, are indicating that telemarketers have switched to using demand drafts now that they understand how easily their ACH payments can be traced.”³

The Office of the Comptroller of the Currency describes these two scenarios in which demand drafts are used to facilitate telemarketing fraud:

Example 1: The criminal calls a consumer and announces that the consumer has won a cash prize. The criminal explains that, to deposit the prize into the “winner’s” account, he or she needs the account information. Once the consumer provides the account information, the criminal prepares demand drafts and withdraws funds from the account. (A common variant is for the criminal to offer the consumer something for sale, such as a magazine subscription, in order to get the necessary account information.)

Example 2: A representative of a criminal organization contacts potential credit card users and promises to arrange for them to get VISA or MasterCard credit cards. The representative asks for checking account information to issue the card and, when the information is provided, prepares demand drafts against the consumers’ accounts.⁴

Anecdotal evidence from a number of states suggests that demand drafts employed by those engaged in fraud are a major problem for consumers. North Carolina reports having received many consumer complaints about unauthorized demand drafts, which have increased over time. Unfortunately, as is true in other states, much of the available data does not distinguish between demand drafts and other types of bank account debits.

One of the features of bank debits that makes them an ideal method of siphoning

² Compare FTC, National and State Trends in Fraud & Identity Theft, January-December 2004 at 7, with National and State Trends in Fraud & Identity Theft, January-December 2003 at 7.

³ *Unauthorized ACH Telephone Payments Down 88%; Telemarketers Switching to Demand Drafts*, ELECTRONIC PAYMENTS JOURNAL, Nov./Dec. 2003, at 7 (quoting NACHA President Elliott C. McEntee).

⁴ Office of the Comptroller of the Currency, *Check Fraud: A Guide to Avoiding Losses*.

money from consumers is that the ability of third parties to debit individuals' bank accounts without authorization appears not to be widely known. Unlike access to credit card numbers, which is commonly viewed as creating the risk of an unauthorized charge, the fact that a stranger can pull money out of a person's bank account using only the numbers at the bottom of his or her check is not commonly understood. "The surprise for many consumers is that withdrawals from their checking accounts can happen on a one-time basis, with no prior authorization."⁵ Back in 1996, even the FTC was surprised to learn about this.⁶

The harm that can befall consumers due to unauthorized demand drafts is illustrated by the case of Elizabeth C., a resident of North Carolina:

Ms. C. is an 86-year-old woman confined to an assisted living care facility. She receives \$640 in social security income, which is used to pay for her medical expenses. According to her daughter, Ms. C. received an unsolicited phone call at the care center in February 2004. Apparently, Ms. C. gave the telemarketer her bank account number and draft authorization to receive what the telemarketer claimed to be a "medical discount prescription" card. On February 23, 2004, \$399 was withdrawn from Ms. C.'s bank account by demand draft.

Within a matter of months, Ms. C.'s checking account was subject to 11 unauthorized demand drafts by unknown entities totaling \$3,885. According to the victim and her daughter, Ms. C. received only the February 2004 telephone call from a telemarketer. Ms. C.'s daughter closed and reopened a new bank account for her mother in October 2004.

Unfortunately, soon after her daughter closed her checking account, scammers misled Ms. C. by mailing her a form letter requesting her new checking account number. Again, from October 2004 to March 2005, Ms. C. was subject to unauthorized demand drafts, totaling \$3,330.

Over the past year, Ms. C.'s daughter has closed and reopened a new account for her mother twice, and yet third parties have still obtained unauthorized access to her checking account.

The victim's daughter recently has obtained Power of Attorney over her mother's financial affairs and has been required to open a separate bank account under her own name to protect her mother's meager monthly SSN income from unauthorized demand draft charges.

⁵ *Demand Draft Fraud*, Prepared Statement of the FTC presented by Jodie Bernstein, Director of the Bureau of Consumer Protection, before the House Banking Committee (Apr. 15, 1996); see also Consuelo Lauda Kertz & Lisa Boardman Burnette, *Telemarketing Tug-of-War: Balancing Telephone Information Technology and the First Amendment with Consumer Protection and Privacy*, 43 SYR. L. REV. 1029, 1056 (1992) (describing telemarketers' ruse of obtaining consumers' check account numbers ostensibly to verify a prize or sale).

⁶ *Id.*

A review of the demand drafts has revealed that many of the debits were initiated by the same entities using different merchant names and employing multiple third-party processors.

There are many stories like Ms. C.'s, and what is more, complaints about unauthorized bank debits are believed to be grossly underreported, perhaps because of the lack of public awareness of this type of bank account vulnerability. For example, in 2004, after the Vermont Attorney General's Office received a complaint from the adult daughter of a senior citizen concerning an unauthorized \$398 demand draft, state investigators uncovered some 100 unreported drafts by the same originator totaling \$40,000—a ratio of 100 to 1.

The *Pharmacycards.com* case being litigated by the FTC is another example.⁷ There, defendants used stolen corporate and individual identity documents to establish relationships with U.S.-based payment processors. The defendants then proceeded to initiate \$10 million in unauthorized demand draft debits from more than 90,000 consumers' accounts, \$139 at a time. Apparently, no consumer provided his or her bank account information to the defendants. The source of the bank account information is unclear. Even though over 50,000 of the transactions were cancelled or returned, more than \$1 million was wired to Cyprus before the scheme was shut down.

Consumers are not the only victims of unauthorized demand drafts. In January 2003, a bank in Vermont that had opened an account for a Canadian aggregator—who served as a middleman man for cross-border telemarketers—received a delivery of more than 700 demand drafts totaling some \$230,000, which were deposited in the aggregator's account. In the process the bank itself suffered a loss of \$10,500.

Similarly, a January 2002 survey by the Community Bankers of Wisconsin found that consumers in that state had lost \$2.8 million and financial institutions \$1.75 million during the previous year.⁸ In response to the same survey, one community bank monitored every third-party draft for a 16-month period, 2,032 drafts in all, and called account holders for which the bank did not have written authorization; 73% of the drafts were returned as unauthorized.⁹

⁷ See *FTC v. 3rd Union Card Services, Inc., d/b/a Pharmacycards.com*, No. CV-S-04-0712-RCJ-RJJ (D. Nev. May 24, 2004) (Complaint for Injunction and Other Equitable Relief).

⁸ Memorandum to the Wisconsin State Senate re Support of LRB-4416/2 (Jan. 28, 2002).

⁹ *Id.* Comments filed by banks in connection with the current rulemaking echo these concerns. See, e.g., comments of Patti Conrad, TowneBank/Security Officer (Mar. 9, 2005) ("Fraud activity has increased so much over the past two-three years on these paper drafts, and customer account information is easily compromised."); Sterling J.U. Laffitte, President, The Exchange Bank (Mar. 9, 2005) ("I am thrilled that you proposed a remedy to the ever increasing problem of these paper drafts. It has become highly abusive and these con artist[s] seem to often prey on the elderly."); Greg Messer, Operations Supervisor, Bank of Frio Canyon (Mar. 9, 2005) ("We at the Bank of Frio Canyon agree that fraud by paper drafts is becoming an increasingly serious issue that has touched us as well."); Carol Clausen, Vice President and Cashier, American State Bank (Mar. 14, 2005) ("We see many of our customers being hurt with this type of scamming going on and it seems to be increasing all the time."); Phil Menhusen, Executive Vice President,

There are several factors besides lack of consumer awareness that make demand drafts a useful tool in the fraudulent telemarketer's arsenal. One is the ease with which demand drafts can be created. Such drafts can be printed using software and ink that can be ordered over the Internet, or contracted out to companies that will print the checks for a fee.¹⁰ As one processor puts it,

Bank drafts or checks are used by merchants who cannot establish an ACH merchant account because they may operate in a high-risk [sic] industry. ... Our system is **very easy to use**. You simply upload a file of your transactions to our online gateway. We perform verification, "scrub the file," print the checks, deposit the checks, clear the funds and wire your funds to you. What could be easier?¹¹

A second feature of demand drafts favoring their use by those engaged in fraud is the fact that the perpetrator, or his processors, does not need to have special access to the banking system, such as is required to process ACH debits. A processor can deposit the drafts to his own bank account and wire the funds to the originator, or send the drafts to the originator or the originator's bank for deposit.

Moreover, since it is impossible to distinguish demand drafts from regular checks, it is difficult, if not impossible, to track the drafts, whether in real time or retrospectively. The potential for spotting national patterns of high returns, and thus taking preventive or systemic law enforcement action is undermined as a consequence.¹²

State Exchange Bank (Mar. 17, 2005) ("Unscrupulous tele-marketers and identity thieves are currently able to deposit unsigned checks into their accounts with impunity."). *See also* a comment more critical of the banking system itself from Rod Lueders, Vice President, Morgan Federal Bank (Mar. 8, 2005) ("It is obvious some banks cater to the telephone and internet scam industry and knowingly provide the conduit to enable these thieves to succeed.")

¹⁰ *See, e.g.*, the websites of CheckMaster 2000, <<http://www.checkmaster.com>> (Apr. 5, 2005) (offering "MICR check printing packages" and estimating cost of printing drafts at less than two cents each); Accelerated Payment Systems, Inc., <<http://www.acceleratedpayment.com/pac.htm>> (Mar. 28, 2005) (offering to print demand drafts).

¹¹ National EFT, <<http://nationaleft.com/bankdrafts.html>> (Mar. 28, 2005).

¹² Legal restrictions with respect to demand drafts initiated by telemarketers exist, but are limited. At the federal level, the FTC's Telemarketing Sales Rule, 16 C.F.R. § 310.3(a)(3), requires express verifiable authorization, but that may involve no more than (1) a recorded verification, which will omit any deceptive initial call, and which is often ambiguous as to the consumer's authorization; or (2) an after-the-call written confirmation sent to the consumer, whose non-existence is difficult for the consumer to prove. It appears that only one state has a more rigorous requirement: Vermont's Consumer Fraud Act, 9 V.S.A. § 2464(b)(2), requiring prior written authorization by the consumer for any telemarketing-initiated demand draft, and effective July 1, 2004, imposing strict liability on parties that process drafts without such authorization. *See* <<http://www.leg.state.vt.us/docs/legdoc.cfm?URL=/docs/2006/bills/passed/H-162.htm>>. Contrast these limited and geographically-isolated restrictions with NACHA's broad ban on ACH debits initiated as the result of an outbound telemarketing call to a person with whom the caller has no existing business relationship.

Finally, it is not uncommon for consumers to encounter difficulty obtaining a recredit to their bank account when—if at all—they discover an unauthorized demand draft.¹³ Barriers include unclear or restrictive time frames for requesting a return, uninformed or hostile bank tellers, and the lack of incentives—or the existence of disincentives—to the receiving bank's initiating the return process.¹⁴

2. Demand drafts should be eliminated unless the business community can demonstrate their necessity to the national economy.

The Board is seeking comment on the prevalence and uses of remotely created checks. Unfortunately, the Attorneys General have not been able to identify any reliable source of "hard" data that would be responsive to this question. However, anecdotal evidence suggests that demand drafts are used by legitimate businesses to only a limited extent at this time.

Specifically, in 1996, the FTC declined to require written authorization for demand drafts by telemarketers as part of its Telemarketing Sales Rule because information provided to the agency "tended to refute the proposition that demand drafts are characteristic solely of deceptive telemarketers."¹⁵ In its explanation for the decision, the FTC said that commenters had noted that Fortune 500 companies and other businesses "characterized by quick turn-around transactions now use demand drafts because they recognize that not everyone has a credit card."¹⁶ The FTC specifically cited as examples of businesses that use demand drafts two of the baby Bells, GEICO,

Citicorp, Telecheck, Equifax, Bank of America, Discover Card, Dun and Bradstreet, Olan Mills, and First of America Bank.¹⁷

However, it turns out that now, nine years after the FTC rulemaking, some of these same companies do *not* use demand drafts, or use them to a limited or reduced extent.¹⁸ This change may be explained by the fact that the ACH system now serves as

¹³ See Christopher M. Grengs & Edward S. Adams, *Contracting Around Finality: Transforming Price v. Neal from Dictate to Default*, 89 MINN. L. REV. 163, 186 (2004) (noting that payor bank can claim that account holder's negligence led to unauthorized debit; "The resulting, strong-form conclusion is that, 'consumers can virtually never enforce their rights against a bank because it will simply be too expensive to do so.'" (quoting Mike Mills, *FCC Proposes Clampdown On 900-Number Services*, CONG. Q. WKLY. REP. (Mar. 16, 1991) at 664)).

¹⁴ See, e.g., Uniform Commercial Code § 4-406(c), requiring that as a condition of successfully asserting lack of authorization against the payor bank, the customer must exercise "reasonable promptness" in examining his or her bank statement and "promptly" notify the bank—without any further specification of how long the customer has to discharge those obligations.

¹⁵ 60 Fed. Reg. 43842-01, 43849 (1995).

¹⁶ *Id.*

¹⁷ *Id.* n.80.

¹⁸ Telephone calls from Vermont Investigator Rose Hayes to Laura Carden, Chief Financial Officer, Olan

an adequate substitute for businesses and consumers wanting to debit bank accounts remotely.

The importance of this issue to the pending rulemaking is clear: if demand drafts are not commonly used, or if there is a ready substitute for them, then one approach to addressing demand draft fraud is to eliminate the use of the drafts entirely. That would be consistent with the course chosen by the Canadian Payments Association (“CPA”), which, effective January 1, 2004, prohibited pre-authorized debits, including demand drafts, which are not supported by an underlying written authorization.¹⁹ According to the CPA, inquiries directed to its major members indicate that the ban has been very successful in two ways: demand drafts are not showing up in the Canadian banking system; and there has been no complaint about the ban from companies that may have used these instruments in the past, such as bill collectors and payday lenders.²⁰

The Board has the authority to prohibit demand drafts under the Expedited Funds Availability Act, 12 U.S.C. § 4008(c)(1). That subsection states, “In order to carry out the provisions of this chapter, the Board of Governors of the Federal Reserve System shall have the responsibility to regulate—(A) *any* aspect of the payment system, including the receipt, payment, collection, or clearing of checks; and (B) *any related function of the payment system with respect to checks.*” (Emphasis added.)²¹

Mills (Apr. 11, 2005) (company no longer uses demand drafts); to Ed Gross, Director, Treasurer's Office, GEICO (Apr. 11, 2005) (currently 4% of company's payments are by demand draft, but that percentage is expected to drop to less than 1% as ACH debits are required); to Richard Goerss, Corporate Vice President and Regulatory Counsel, Equifax (Apr. 12, 2005) (company has sold its collections business and does not use demand drafts); to Kim Smith, Director of Banking Relations and Credit Policy, Verizon (Apr. 12, 2005) (company does not use demand drafts); David Sloboden, Vice President, Legal, Litigation and Human Resources, Dun & Bradstreet (Apr. 13, 2005) (before the sale of its collections department, Dun & Bradstreet used demand drafts, but it does not use them now); telephone call from Vermont Assistant Attorney General Elliot Burg to James Swift, Vice President and Assistant General Counsel, Discover Financial Service, Inc. (Apr. 12-13, 2005) (demand drafts represent 2% of credit card payments; company would prefer to use ACH, but for the need under Regulation E to obtain written authorization from consumers who are making more than two payments); email from Sheri L. Mullane, Assistant General Counsel, Bank of America to Investigator Rose Hayes (Apr. 14, 2005) (bank uses demand drafts in approximately 4% of its transactions). First of America Bank was bought out by two other banks and no longer exists. Efforts to obtain comparable information from CitiGroup and Telecheck were unsuccessful.

¹⁹ CPA, Rule H1 (Pre-Authorized Debits (PADs)) §2. (“Any debit issued by a payee, such as a one-time debit, that is not supported by an underlying pre-authorized written agreement is not permitted under this rule.”) A “pre-authorized debit” is a payment item issued by a payee that is drawn on the account of a payor held by a processing institution. § 5(i).

²⁰ Telephone call from Doug Kreviazuk, Vice-President, Policy and Research, CPA, to Elliot Burg, Vermont Assistant Attorney General (Apr. 7, 2005).

²¹ If the business community does demonstrate a legitimate need for demand drafts in some situations, the Board may also wish to consider permitting such drafts *only* where an account holder has expressly authorized his or her bank to accept them for purposes of debiting the account, in combination with requiring originating banks to warrant authorization and mandating a special MICR identifier (see section 4 of the text).

3. Originating banks as well as receiving banks should bear warranty liability.

In the event that the Board does not undertake to prohibit the use of demand drafts, it should clarify that the imposition of warranty liability on the originating bank with respect to the drawer's authorization for a demand draft is *in addition to* the comparable warranty liability now borne by the receiving/drawee bank. That is, updating the rule of *Price v. Neal*²² should not mean that consumers have no direct recourse from their own bank for unauthorized demand drafts.

This clarification is particularly important because of the possibility that banks—for instance, foreign banks not subject to the Board's rules—could occupy the role of originating financial institution. If the originating bank cannot be compelled to make the consumer whole, then as between the consumer and the consumer's bank (assuming lack of authorization and prompt notification by the account holder), the bank is in the better position to protect itself.

Otherwise, a national standard requiring originating banks to warrant that demand drafts are authorized is unquestionably better for consumers than a state-by-state approach. At present, originating banks in most states²³ are not subject to a warranty-of-authorization obligation, which can create a disincentive for consumers' banks to recredit their customers' accounts, since they (the consumers' banks) may end up absorbing the loss.

In a related vein, the Board should consider extending the benefits of the proposed warranties (or clarifying that the warranties extend) to the *drawer*, so that the account holder would have a regulatory warranty claim against his or her own bank. The existence of this claim would enhance the incentives for the payor bank, in a close case, to make its customer whole and pursue the warranties "upstream" to the depository bank.

As for the question of whether there should be a distinction drawn between consumer and non-consumer accounts, the better view is to reject such a distinction. For one thing, having to identify accounts as falling into one category or the other can be logistically difficult. For another, at least in some states, businesses can be considered "consumers" for some purposes²⁴ and should, in those contexts, receive no less protection than individual consumers.

4. Demand drafts should be specially marked as such.

The Board has asked whether demand drafts should be specially marked in the

²² 97 Eng. Rep. 871 (K.B. 1762).

²³ This reference is to the banks in all but the 14 states that have amended their Uniform Commercial Codes to create such a warranty obligation.

²⁴ See, e.g., 9 Vt. Stat. Annot. § 2451a(a).

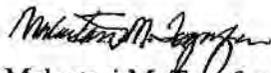
MICR line. It is true, as the Board notes, that those initiating or processing an unauthorized draft are unlikely to comply with such a requirement. For this reason, consideration should also be given to ways of optically or otherwise recognizing demand drafts based on their unsigned nature. If there were ways of tracking demand drafts similar to the methods available for ACH debits, that would be beneficial to law enforcement agencies.

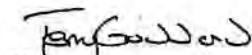
5. Extension of the midnight deadline.

The Board has also asked for comment on whether the midnight deadline for returning items as provided for in the UCC²⁵ should be extended—for example, to 60 days, as is the case with ACH transactions. If the Board determines that the ACH system has not been adversely affected by its longer deadline—that legitimate commerce has not been impeded by permitting returns for unauthorized electronic debits for a considerably longer time than with respect to paper drafts—then serious consideration should be given to applying at least an 60-day return period to demand drafts. If a receiving bank has the option of returning an unauthorized demand draft to the originating bank, rather than pursuing a potentially more expensive and uncertain warranty claim, that should make it easier for consumers to recover funds lost due to fraud.²⁶

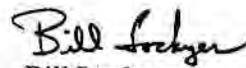
We appreciate this opportunity to comment on the proposed rule, and thank you for your consideration of our views. If you have questions about these comments, please feel free to contact Elliot Burg, Vermont Assistant Attorney General, at (802) 828-2153; Erin Leahy, Ohio Assistant Attorney General, at (614) 752-4730; or Dennis Cuevas, NAAG Consumer Protection Project Manager and Counsel, at (202) 326-6019.

Sincerely,


Malaetasi M. Togafau
Attorney General of American Samoa

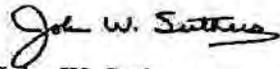

Terry Goddard
Attorney General of Arizona


Mike Beebe
Attorney General of Arkansas


Bill Lockyer
Attorney General of California

²⁵ See UCC §§ 4-301 and 4-302.

²⁶ Many of the comments filed by bankers in response to this rulemaking support extension of the deadline to 60 days. See, e.g., comments of Lucy Jones, Executive Vice President, Western National Bank (Mar. 15, 2005); Stacey Adkins, Assistant Vice President, Hebron Savings Bank (Mar. 25, 2005); Beverly F. Rutherford, Vice President/Compliance, Virginia Credit Union (Mar. 30, 2005); Carlton Cowan, Fraud Prevention Officer, The Bank of Edwardsville (Mar. 18, 2005).



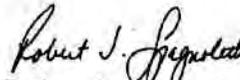
John W. Suthers
Attorney General of Colorado



Richard Blumenthal
Attorney General of Connecticut



M. Jane Brady
Attorney General of Delaware



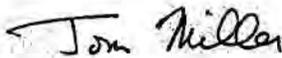
Robert J. Spagnoletti
Attorney General of the
District of Columbia



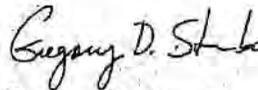
Stephen H. Levins
Executive Director
Office of Consumer Protection of Hawaii*



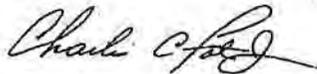
Lisa Madigan
Attorney General of Illinois



Tom Miller
Attorney General of Iowa



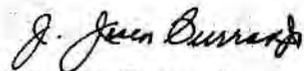
Gregory D. Stumbo
Attorney General of Kentucky



Charles C. Foti, Jr.
Attorney General of Louisiana



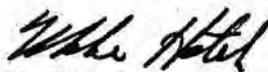
G. Steven Rowe
Attorney General of Maine



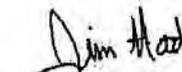
J. Joseph Curran, Jr.
Attorney General of Maryland



Tom Reilly
Attorney General of Massachusetts



Mike Hatch
Attorney General of Minnesota

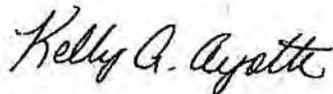


Jim Hood
Attorney General of Mississippi

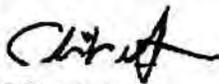
*Of the states listed, Hawaii is not represented by its Attorney General. Hawaii is represented by its Office of Consumer Protection, an agency which is not a part of the state Attorney General's Office, but which is statutorily authorized to represent the State of Hawaii in consumer protection actions. For the sake of simplicity, the entire group will be referred to as the "Attorneys General," and such designation as it pertains to Hawaii, refers to the Executive Director of the State of Hawaii Office of Consumer Protection.



Mike McGrath
Attorney General of Montana



Kelly A. Ayotte
Attorney General of New Hampshire



Eliot Spitzer
Attorney General of New York



Wayne Stenehjem
Attorney General of North Dakota



W. A. Drew Edmondson
Attorney General of Oklahoma



Thomas W. Corbett, Jr.
Attorney General of Pennsylvania



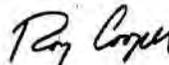
Henry D. McMaster
Attorney General of South Carolina



Brian Sandoval
Attorney General of Nevada



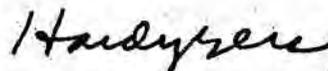
Patricia A. Madrid
Attorney General of New Mexico



Roy Cooper
Attorney General of North Carolina



Jim Petro
Attorney General of Ohio



Hardy Myers
Attorney General of Oregon



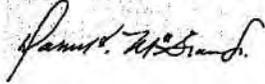
Patrick C. Lynch
Attorney General of Rhode Island



Lawrence E. Eong
Attorney General of South Dakota



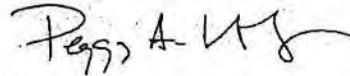
Paul G. Summers
Attorney General of Tennessee



Darrell V. McGraw, Jr.
Attorney General of West Virginia



William H. Sorrell
Attorney General of Vermont



Peg Lautenschlager
Attorney General of Wisconsin