Comments
of the
National Consumer Law Center
and
Consumer Federation of America
to the
Federal Reserve Board
Docket No. R-1265
12 CFR Part 205

Regulation E – Electronic Fund Transfer Act

September 28, 2006

The **National Consumer Law Center ("NCLC")**[1] submits the following comments on behalf of its low income clients, as well as the **Consumer Federation of America,**[2] regarding the Board's Interim Final Rule interpreting the Electronic Fund Transfer Act. The changes proposed in this Interim Final Rule relating to the legality of a merchant's electronic collection of a fee for insufficient funds are only incremental – they seek to clarify *who* can electronically debit this fee. However, our comments address the underlying issue of *whether a consumer has authorized* the electronic debit of this fee simply by virtue of having received notice of it. We are very concerned about the growing problem of Internet and storefront payday lenders and their ability to electronically debit consumers' accounts for payday loans, as well as the exorbitant fees for these payday loans. We therefore question both the wisdom and the legality of allowing the electronic collection of a fee for insufficient funds simply based upon the consumer's use of the payment mechanism after receiving notice that a fee will be electronically debited.

---

[1] The **National Consumer Law Center**, Inc. (NCLC) is a non-profit Massachusetts corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of seventeen practice treatises and annual supplements on consumer laws, including Consumer Banking and Payments Law (3rd ed. 2005), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for tens of thousands of legal services and private attorneys on the law and litigation strategies to deal with predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and regularly provide comprehensive comments to the federal agencies on the regulations under these laws. These comments are written by Margot Saunders and John Van Alst.

[2] **Consumer Federation of America,** is a nonprofit association of over 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through research, advocacy and education.

The Electronic Fund Transfer Act ("EFTA") only permits electronic access to a consumer's account if the consumer has authorized this access.[3] I in its previous change to the Regulation allowing the electronic debiting of a fee for insufficient funds,[4] the Board mistakenly conflated notice with authorization. Just because the consumer has received notice that this fee will be electronically collected if the check bounces, does not mean that the consumer has authorized this fee to be electronically debited.

The Board has allowed a paper check to be electronically transmitted (an ECK transaction) based on the consumer's receipt of a notice to that effect, and the consumer's continued use of the paper check after receiving that notice.[5] We believe this is distinguishable from the situation that we are concerned with in this docket. When a consumer writes a paper check but then receives notice that the paper check will be electronically presented, and then continues with the transaction, the Board has found that constitutes sufficient evidence to infer that the authorization for the electronic transaction has occurred. This is because this is a logical, sequential, and clear progress of events: paper check written – notice that a paper check will be electronically presented – continued use of the paper check after receiving this notice of electronic presentment. In this case, the consumer clearly has the opportunity to change the method by which they will pay and withdraw the paper check after receiving the notice of electronic presentment and use an alternative method of payment.

However, the scenario is quite different when the electronic transaction is only one that *may* occur – as is the case when the money that is to be electronically transmitted is a fee for the insufficient funds. The consumer who presents a check or authorizes an electronic debit after receiving notice that a fee for insufficient funds will be electronically debited is *clearly not planning to have her check be returned* for insufficient funds. If the consumer were to write a check knowing that it would bounce, that would be a crime in most states. Indeed, the vast majority of checks that are written do not bounce. In 2003, only .05% of checks were returned unpaid by depository institutions.[6] The consumer who writes a check after receiving notice that a fee for insufficient funds will be electronically debited from the account has *not* authorized this electronic debit. The consumer generally has no intention of writing a bad check, and so has not agreed to the contingency of what will happen in the unlikely scenario that the check will bounce.

---

[3] The requirement that the consumer must *authorize* the electronic transfer is implicit throughout the EFTA, and has been completely accepted by the Board, as is evident by this Interim Final Rule, in which the Board consistently hinges the legality of the electronic transfer upon the determination that the consumer has authorized it. The Act itself most clearly requires the consumer's actual authorization of an electronic transfer in the definition of an "*unauthorized* electronic transfer in Section 205.2(m):

> *Unauthorized electronic transfer* means an electronic fund transfer from a consumer's account initiated by a person other than the consumer without actual authority to initiate the transfer and from which the consumer receives no benefit.

[4] 71 Fed. Reg. 51456

[5] Reg. E, 12 CFR §205.3(b)(2)(ii)

[6] *Depository Institutions Payments Study,* Federal Reserve System 2004

The Board has inappropriately confused the idea of *notice* with the legal requirement for *authorization* in this instance. For authorization to follow simply after notice, logic requires that the sequence of events must be clear and unequivocal – and be reasonably predictable. This is not the case here. New Section 205.3(b) allows a fee for insufficient funds to be electronically debited simply after the consumer has received a notice that this may occur *in the unlikely event* that the consumer's check actually bounces. For this authorization to be implied from the provision of this notice, one must presume that the consumer contemplated committing a crime – the crime of writing a check when the consumer knows that there are not sufficient funds to cover the check. This cannot – and should not – be an appropriate interpretation of the requirements for authorization before funds can be electronically debited from a consumer account in the EFTA.

This careful analysis of what is legal authorization for the debiting of a fee for insufficient or uncollected funds is extremely important in the Internet payday lending context. Internet payday lenders obtain access to consumers' account information in the early stages of the initial loan transaction and proceed to use that information to take over consumers' ability to control their finances.[7] Once such lenders have the information to access the consumer's account, the consumer finds it difficult if not impossible to make any further decisions regarding paying the debt or limiting access to the consumer's account. With traditional debts, consumers are in control of when and if payments will be made. Consumers may decide to face the consequences of paying a debt late or not at all based upon their needs. Internet payday borrowers have no such autonomy over their finances. The lender generally decides when and how often the consumer's account will be electronically debited. Even if the consumer attempts to revoke authority for electronic fund transfers, many lenders then simply illegally – and without authorization -- debit the account by means of a remotely created check.

Borrowers often assume that the entire debit will be paid on their next payday, however many lenders provide that the debt will automatically "roll over" absent some express request by the borrower. When the term of this high-interest loan is extended, contrary to the understanding of the consumer, the resulting interest increases the likelihood that subsequent debits will be returned NSF.

This lack of control over their own account makes the electronic debiting of NSF fees so important to consumers in Internet payday lending. Unable to control the debiting of their accounts, consumers face multiple NSF fees from both their financial institutions and the payday lenders. Payday lenders attempt to debit consumers' accounts for amounts and at times not selected by the consumers. Lenders also submit multiple debits on the same day and attempt to charge the consumer another NSF fee upon each return.[8]

---

[7] For a more complete discussion of the practices used by the Internet payday lending industry see: Consumer Federation of America, *How high-Priced Lenders Use the Internet to Mire Borrowers in debt and Evade State Consumer Protections* (Nov. 30, 2004), *available at* http://www.consumerfed.org/pdfs/Internet_Payday_Lending113004.PDF.

[8] The actions of the payday lender described in the attached affidavit exemplify the practice of Internet payday lenders submitting the same debit multiple times on a single day and the harmful effect this practice has on consumers.

The subsequent imposition of unauthorized NSF fees electronically debited by the lender exacerbates this dangerous situation and greatly increases the likelihood that other instruments drawn by the consumer will be returned for insufficient funds.

In order for the consumer to authorize the electronic debiting of funds there must first be a clear understanding on both sides of the consequences of that authorization. There is no such understanding – and therefore no authorization – when a consumer is uncertain of whether there will be such a debit. Authorization is typically demonstrated by express and knowing actions. Authorization, similar to the terms of a contract, is not shown or formed by mere notice, but by clear understanding and agreement. A consumer could not expect to change the terms of a retail sale merely by wearing a T-shirt that states “No sales are final- full cash refund for two years” while purchasing an item. Likewise, authorization cannot be inferred from a mere notice posted by one side of a transaction that proposes what might happen upon some contingency. In the scenario permissible under the proposed interim final rule, a creditor cannot be certain that the consumer saw or understood the proposal, much less authorized the debit.

An electronic debiting of the consumer’s account by a payee for NSF fees, unless actually authorized by the consumer, is done without authority, and provides no benefit to the consumer. For the forgoing reasons, authorization to electronically debit NSF fees should require the same understanding and agreement as any other electronic transfer.