Legislative and Regulatory Developments Affecting Deposit Accounts and Payment Transactions

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By Alvin C. Harrell

I. The 2005 and 2006 FRB Amendments

In 2005 and 2006, the Federal Reserve Board (FRB) finalized various regulatory amendments that affect common deposit account transactions. The first 2005 FRB amendment focused on Regulation DD, which implements the Truth in Savings Act, clarifying the treatment of certain overdrawn payment services (sometimes called “bounce protection programs”).

Overdraft protection (or “bounce protection”) programs were already subject to extensive state and federal law coverage. The May, 2005 FRB amendments addressed the Truth in Savings Act and Regulation DD disclosures, and also the impact of the Truth in Lending Act (TILA) and Regulation Z on the credit aspects of bounce protection programs. Generally these 2005 rules require banks to disclose their overdraft and returned-items charges to the customer when a deposit account is opened (including the categories of transactions on which the charges may be imposed), and additionally require disclosure of the aggregate charges for overdrafts and returned-items by banks that advertise overdraft protection services.

The second 2005 FRB amendment was to Regulation CC, governing the collection of checks and other items through the banking system. This November, 2005 amendment modifies the effect of Price v. Neal for “remotely created checks.”

Then in January, 2006 the FRB amended Regulation E, governing electronic check conversion; this was followed in August, 2006 by a revised interim rule and ultimately by publication on December 1, 2006 of a revised final rule amending Regulation E.

In addition, as described in a previous article, in 2002 the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved amendments to the uniform text of Uniform Commercial Code (UCC) Articles 3 and 4. These amendments address various matters, including the remotely-created consumer items that are also subject to the November, 2005 FRB regulatory amendments.

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A. Scope

The November 2005 FRB amendment to Regulation CC (conforming amendments to FRB Regulation J) covering remotely created "telephoned" drafts, is generally consistent with but differs slightly from the equivalent 2002 revisions to the uniform text of UCC Articles 3 and 4. The UCC revisions apply to "remotely created consumer items," thereby making clear that such items under UCC Article 4 are and are not subject to the Article 4 bank collection rules, even though they are not negotiable instruments or checks under Article 3 section 3-104 (because they are not signed by the drawer). The UCC definition of "remotely created consumer item" at section 3-103(a)(16) also specifies that the applicable rules are limited to those that apply to consumer accounts.

The 2005 FRB amendments to Regulation CC, in contrast, apply to "remotely created checks." These are defined in paragraph (a) of the amendments as checks, even though they are not checks under the UCC or traditional commercial law standards (e.g., UCC section 3-103(14)) if they are not signed. Nonetheless, under Regulation CC these unsigned drafts are deemed "checks" because they are drawn on an "account," which is defined as an arrangement that allows a "person (apparently including the payee) to draw on funds held by a bank. In addition, the FRB amendments are not limited to items drawn on consumer deposit accounts, the FRB having conceded that there is no "reason to distinguish consumer from nonconsumer accounts for this purpose, in response to bankers' concerns that the expansion of the scope of consumer accounts to which all our checks are made payable at any place for any purpose will be more difficult to manage.

The FRB amendments also define a remotely created check as one "not created by the payee upon a telephoned draft and not drawn or purporting to be drawn by the account holder." Thus, Regulation CC does not distinguish between items drawn by the payee upon a telephoned draft and those drawn by a bill payment service on behalf of the deposit account holder. This language referencing the definition (and thus the scope of the Regulation CC rule) to items not purportedly drawn by the account holder is basically similar to the equivalent UCC Article 3 definition of "remotely created consumer item" at section 3-103(a)(16) ("an item...not created by the payer bank and [not bearing] a handwritten signature purporting to be the signature of the drawer"). The FRB abandoned its earlier proposal to define remotely created checks by reference to "the form" agreed to by the bank and its account holder, recognizing that this would have created a serious and unclear standard.

The FRB also expanded the scope of the new rule, for purposes of warranties, beyond the normal Regulation CC coverage of "consumer accounts," because the latter coverage does not include all deposit accounts on which checks can be drawn. The FRB did not want the risk of remotely generated checks being treated as such, and thus defined the applicable accounts as including any account on which checks (broadly defined, as noted above) can be drawn (line-of-credit accounts, money market accounts, etc.). The FRB also made clear that the new rules apply to "checks payable through or at a bank (rather than being limited to those payable by the consumer bank). And to "substitute checks" created pursuant to the Check Fraud Act. 

B. Impact on the Midwinter Deadline

As discussed in a previous article, the 2005 FRB amendments governing remotely created checks override the effect of Price v. Nea by providing new warranty remedies for the payer bank (UCC 3-401 and 4-406), even though Rule 33 of Regulation CC, allowing unauthorized remotely created checks to be returned after final payment and expiration of the midwinter deadline. The new rules do not directly override the UCC midwinter deadline, but create a new warranty remedy not subject to those rules and deadlines. Thus, as under the 2002 UCC amendments to Article 4, the new Regulation CC remedies for breach of warranty are the only warranty remedies of which the payor bank is aware. This language also eliminates the time limits on assertion of the breach of warranty claim. In all, it is an elegant solution to the problem of telephoned drafts, which leaves in place the principles of Price v. Nea in other common scenarios (where the deposit bank has no motive to police the drawer's signature).

As noted, the November 2005 FRB language largely tracks the warranty language in the 2002 amendments to the UCC's checks article, while simultaneously removing any call for face-to-face presentation of other warranties, and provides welcome symmetry between state and federal law. This language and the related procedures have been a significant step forward, not only in making clear that the new warranties do not cover forged indorsements.

An interesting difference between the 2002 UCC Article 3 and 4 warranties and the 2005 FRB amendments is that the former extend the warranty (the representation that remotely-created consumer items are authorized) to the depositor and other non-bank transferers who received consideration for the item, who transferred the item outside the banking system. Thus, under the UCC revisions the payor bank can recover directly from such parties. In contrast, the new Regulation CC warranties created by the 2005 FRB amendments are imposed on banks only. A primary reason is that the scope of FRB authority extends only with respect to banks. However, this distinction is likely to make little difference, as depositor warranties are generally even more secure than legal recourse against depositors who deposit unauthorized items. Probably the real problem for depositary banks is economy, i.e., collecting from a depositor who may have withdrawn the funds and filed a claim, or is unable or unwilling to pay. In this respect, the limitations on the payor bank's warranty claim at 12 C.F.R. section 229.34(d)(2), effectively allowing the depositary bank to assert the payor bank's preclusion against the payor bank's customer under UCC section 4-406 as a defense, may be the most important legal remedy provided to depositary banks in the new regulations. Two other points addressed in the FRB Supplementary Information are noteworthy. First, the new warranty language could cover the scenario where the payor bank's customer authorizes a remotely created check payable to, e.g., the payer's agent or subcontractor, in which case the payor is liable for the payer's name, to the extent that the result is deemed an unauthorized check. Second, the FRB noted that the problem of "buyer's remorse," i.e., where a bank customer authorizes a remotely created check and then asserts that it was unauthorized because the customer has changed his or her mind about the underlying transaction. The FRB noted that for the Federal Trade Commission (FTC) Telemarketing Sales Rules require telemarketers to obtain the customer's "express verifiable authorization" for a remotely-created check. That evidence would be available to rebut the customer's assertion that the check was unauthorized, and the "paying bank's extension of credit to the customer if the customer had, in fact, authorized the transaction but later suffered "buyer's remorse." The bank would then charge his or her account, as the item would be properly payable.

III. Overdraft Protection Programs

A. Guidance on Overdraft Protections

The 2005 Intergency Guidance on Overdraft Protection Programs (the Guidance) was released in final form by the FRB, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the National Credit Union Administration on February 19, 2005. The Office of Thrift Supervision released a separate guidance on February 14, 2005. These address a number of advertising and Truth in Savings Act (TISA) issues and stipulate certain "Best Practices," e.g., relating to "Marketing and Communication with Consumers" and "Program Features and Operation." These matters impact small businesses as well as consumer deposit accounts.

The Guidance notes that these programs should be reviewed by qualified legal counsel for compliance with applicable laws and regulations. The Guidance addresses various other issues, including safety and soundness considerations, loan documentation, charge-off policies, account maintenance, the allowance for loan...
and lease losses, and third-party technology-related risk management concerns. 64

B. New Account Disclosures for Overdraft Protection Services

In addition to the joint Guidance on Overdraft Protection Programs, 65 the FRB issued amendments to Regulation DD, 66 clarifying certain specified disclosures relating to overdraft protection services. 67

The account-opening disclosures for overdraft protection fees and services, as provided in revised Regulation DD, apply to all depository institutions, regardless of whether the institution offers an overdraft protection plan. 68

Prohibited expansions on misleading advertisements apply to all depository institutions. Additional disclosure requirements for periodic statements (see infra Part III.C) and advertisements apply only to institutions which promote the payment of overdrafts (examples of such promotion include, e.g., stating the overdraft limit for an account on a periodic statement that appears on an account balance that includes available overdraft funds on an automatic teller machine (ATM) receipt; these would be considered advertising the additional disclosures). The disclosure requirements for periodic statements include a separate disclosure of the total dollar amount of fees and charges assessed during the period, an account for paying overdrafts, and the total dollar amount for returning items unpaid (for the statement period and for the calendar year-to-date for such account promoted). Regulation DD includes examples of advertising practices which could be misleading, 69 so as to require additional disclosures in the overdrafts of services advertised.

C. Customer’s Statement of Account

As noted above, the 2005 revisions to FRB Regulation DD require new disclosures with each periodic statement of account (e.g., the monthly bank statement), if the bank promotes overdraft protection services. 70

Under revised 12 CFR section 230.1(a)(1), (a) banking institution which promotes the payment of overdrafts must provide the following required disclosures for each periodic statement of account covering an account for which the bank has promoted the payment of overdrafts: (1) a separate disclosure of the total dollar amount for all fees or charges imposed on the account for paying checks or other items when there are insufficient funds and the account becomes overdrawn; and (2) the total dollar amount for all fees imposed on the account for returning items unpaid.

These disclosures must be provided for the statement period and for the calendar year-to-date, by aggregating the fees imposed since the beginning of the calendar year or since the beginning of the first statement period for that year for which such disclosures are required. The disclosures must be made beginning in the first statement period that begins after such a promotion and must continue until two years after the date of the last such promotion applicable to that account. If a promotion does not specify the types of accounts to which it applies, the additional disclosures are required for all periodic statements covering the institution’s deposits accounts. 71

D. 12 USC 4511 (c)(3)(E)

E. 15 USC 1640(a)(3)(B)

F. 15 USC 1640(a)(3)(B)

G. 15 USC 1640(a)(3)(B)

H. 15 USC 1640(a)(3)(B)

I. 15 USC 1640(a)(3)(B)

J. 15 USC 1640(a)(3)(B)

K. 15 USC 1640(a)(3)(B)

L. 15 USC 1640(a)(3)(B)

M. 15 USC 1640(a)(3)(B)

N. 15 USC 1640(a)(3)(B)

O. 15 USC 1640(a)(3)(B)

P. 15 USC 1640(a)(3)(B)

Q. 15 USC 1640(a)(3)(B)

R. 15 USC 1640(a)(3)(B)

S. 15 USC 1640(a)(3)(B)

T. 15 USC 1640(a)(3)(B)

U. 15 USC 1640(a)(3)(B)

V. 15 USC 1640(a)(3)(B)

W. 15 USC 1640(a)(3)(B)

X. 15 USC 1640(a)(3)(B)

Y. 15 USC 1640(a)(3)(B)

Z. 15 USC 1640(a)(3)(B)
QUARTERLY REPORT

not exceed in Regulation E: A failure to promptly recredit the customer's checking account for the erroneous payment of an improper item is likely to result in the wrongful dishonor of other items drawn on that account, with bank liability under UCC Article 4 section 3-402. Under Regulation E, the financial institution that is unable to complete its investigation within the ten day period noted above can take up to forty-five days (from receipt of the customer's notice) to do so, if the financial institution: (1) provisionally credits the customer's account (including interest where applicable) within the ten-day period; and (2) informs the consumer within two days that the provisional credit has occurred (the consumer must have full use of the funds); (3) corrects any error within one day of determining it; and (4) reports the results of the investigation within three business days of its completion (including, if applicable, that the provisional credit has been made) and any additions to these time limits for new accounts, point-of-sale debit card and out-of-state transactions, etc. The consumer may then hand back the consumer's check, along with any copy of the EFT transaction slip, stating: "Keep this for your records." In this situation (an ECK), where the check is used to initiate an EFT, Regulation E treats the check as merely a "record of information" for the origination of the EFT. Under the 2006 changes to Regulation E, this transaction is treated as an EFT from the beginning, and is never treated as a payment by item. Although it may seem odd to say that an ECK transaction resulting from issuance of a check is entirely an EFT transaction and is never a check, from the standpoint of processing the payment there isn't any check or even an image of a check that is deposited with, sent through, or presented to any banking institution. Thus the FRB concluded that it would be hard to apply the UCC Article 4 rules governing EFTs and that there is never an "issue" under Article 4. It is clear that Article 4 does not apply. Of course the same could be said of the check imaging information that is transmitted between banks under Check 21, but as noted below those transactions remain subject to the check collection regime. Moreover, it should be noted that, even though in this scenario there is never an Article 4 "stem," the check used to initiate the ECK remains an instrument under UCC Article 3; but, if, it is returned to the drawer or destroyed by the merchant, normally it will not be negotiated to a subsequence holder or create additional liability against the drawer, e.g., under Article 3 sections 3-302, 3-305(b), and 3-414.42

D. Electronic Check Initial Disclosures

For new accounts opened on or after January 1, 2007, a bank's disclosures under Regulation E must be modified to list an additional type of EFT--outgoing EFTs from a consumer bank account using ECK information derived from the consumer's check. Sample language appropriate for this new disclosure is set out in model clauses (02C) in Form A-2 of Appendix A to Regulation E. Two other minor, conforming changes were made to clauses (a) and (b) of Form A-2.
to Regulation E, at 12 C.F.R. section 205.3, clarifies that the transmission of an electronic check image for collection purposes is not an ECK, nor an EFT, but merely an electronic method for collection and presentation of the check itself. The image that passes through the payment system is still treated as a check and is an Article 4 "item," and is governed by UCC Article 4 and as such is also covered by Article 3 and Regulation CC, not Regulation E.

A new paragraph 205.3(c)(1) of the FRB Official Staff Commentary to Regulation E advises that electronic re-presentation of a returned (dishonored) check is also not covered by Regulation E (and is not considered an ECK transmission), because the original presentment of the check was never an item in written form, so it was not originator as an ECK. This is one of the issues further clarified in the revised final rule published December 1, 2006. The Regulation E requirements apply to any returned item fee, not just fees for items returned because of insufficient funds.

The new rules bringing ECK into Regulation E apply only when information from a check is used as a source of information for a "one-time" EFT transaction from a consumer account. Regulation E has a different rule (in 12 CFR section 205.10) for "pre-authorized transfers," which means a series of debits to the customer's account occurring at least once every sixty days. Pre-authorized transfers can include such items as automatic withdrawals for utilities, bills, mortgages, etc. The deposit account customer typically provides a deposit slip or voided check to the originator of the transaction to confirm the真实性 of the pre-authorized transfers. Although a check may be used as a "source of information" to originate a pre-authorized transfer, these transactions are not covered by the new ECK provisions because the check information is not used to initiate a "one-time" EFT. (c) The check information is used to initiate a "one-time" EFT. (c) The check information is used to initiate a "one-time" EFT.

F. Check Conversion by Merchants

Previously, Regulation E applied only to financial institutions. ECK-occurrences at the point of sale (POS), or when the customer mails a check in response to a periodic billing statement such as a utility bill (i.e., check conversions by merchants and other payees) have been outside the scope of Regulation E—although governed by the National Automated Clearing House Association (NACHA) rules requiring authorization for originating an electronic check. As an increasing number of merchants and other commercial payees (including those receiving check payments by mail) began collecting checks via ECK, instead of depositing the actual checks, the FRB contemplated an expansion of Regulation E to cover these transactions. The 2006 Regulation E revisions were a culmination of these efforts, and are designed to help consumers understand the nature and potential consequences of these ECK transactions. As stated in the 2006 Final Rule, the revisions bring merchants and other payees under the coverage of Regulation E for the first time, for the limited purposes of standardizing the disclosure notices that customers must receive and determining what constitutes authorization to originate an EFT. Merchants and other payees are now required to make certain disclosures available to the consumer and to obtain the customer's authorization before an ECK occurs, as noted above. This new rule provided for the new notice of returned item charge to be delayed. (G) Required Notice at POS Locations

1. Types of Notices

Regulation E, at 12 CFR section 205.3(x)(2)(i)(H), now requires that a specified ECK notice be provided by the merchant to the consumer at the POS location, in order to authorize the merchant to electronically convert the consumer's check (an ECK). The consumer must receive notice in two ways (both involving signs or the same disclosure at the POS transactions. First, the POS notice "must be posted in a prominent and conspicuous location" (as noted above). A copy of the notice must be provided to the consumer at the time of the [POS] transaction. This notice might be printed on the consumer's copy of the authorization slip signed by the consumer in connection with the ECK. The notice also might be posted on a cash register receipt, or on a separate piece of paper handed to the consumer at the time of the POS transaction. (2) The ECK Notice

Model clause (a) of new Form A-6 in Appendix A of Regulation E has specimen text for the disclosure notice to be provided to consumers. Disclosures from two separate paragraphs in clause (a) must be provided to the consumer: (1) that his or her check may be electronically converted (an ECK); and (2) that a returned-item fee of a stated amount will be imposed if the check is returned. As in the standard EFT disclosure, the revised ECK disclosure notice must be provided in a form that the consumer can keep, such as by printing the notice on each cash register receipt. This notice is not a pre-approved credit practice, which previously included a posted notice at the register but not an electronic returned-check notification. The consumer can keep with respect to each check-based POS transaction. Apparently, many merchants' systems were not able to accommodate this change, leading to the December 1, 2006, revised rule delaying this requirement.

The revised final rule published December 1, 2006, in the Federal Register clarifying that the 2006 rule applies to all returned-item charges, not just NSF charges) provided that if the merchant could not provide the return-notice in a form the consumer can keep prior to the transaction (as initially required, in the January, 2006 rule), this notice may be given later. The notice still had to be posted prior to the transaction. However, the original requirement was not a "must" and it has not prohibited the needed update of merchant processing systems. Thus, as of January 1, 2007 all of the Regulation E revisions were effective except the requirement to give notice before the transaction of the EFT-returned-item charge, in a form the consumer can keep, this requirement became effective January 1, 2008. A third provision, new model clause (c) in Form A-6 in Appendix A, must be given by all merchants who will engage in ECK, but also must be given by merchants who will only originate EFTs for returned-item charges. This model clause (c) must be posted in a "prominent and conspicuous" location (e.g., at the cash register), but a copy does not have to be given to the consumer. Model clause (c) states: "When we use information from your check to make a electronic fund transfer, funds may be withdrawn from your account as soon as the same day you make [we receive] your payment [and, you will not receive your check back from your financial institution]." This model clause (c) addresses two possible misunderstandings: (1) a consumer may not recognize that an electronic returned check (an ECK or an EFT for returned-item charges) could be paid as early as the same day; and (2) a consumer may be expecting that her or his check (or an image) will be returned to him or her with the periodic statement—particularly if she or she mails a check as payment, or the check for some reason is not returned back at the time of a POS transaction. The first half of model clause (c) must be given even by a merchant who originates EFTs for returned-item charges, but never converts checks electronically in an ECK. If the only EFTs will be for returned-item charges, the second half of model clause (c) will not apply, because the consumer will never give a check for the returned-item charge.
4. Related POS Requirements

In a POS transaction, the notice should indicate that the EFT could be paid from the consumer's account as early as the next business day. A layman may not fully understand payment, "not the same day we receive your payment." The "same day we receive your payment" language applies to the time the transaction is debited to the customer's account.

The second half of model clause (c) ("and you will not receive the check back from your financial institution") can be deleted in POS transactions where the merchant always hands the consumer's check back to the customer. Regulation E, however, does not assume that a check always will be handed back to the consumer. For example, the merchant's bank office might conceivably cash a check to an EFT later, and then destroy the check.

The requirement to include model clause (c) currently applies only from 2007 through 2009. After 2009, the FRB states that the statute may be unnecessary, because consumers will be more familiar with the nature of these transactions. Possibly these changes will be revisited before then.

II. Notice for Billing Statements and ARC Transactions

In an account receivable conversion (ARC) transaction, the consumer mails a payment to a payee, such as a utility company or mortgage company. The company receiving the check electronically converts it to an EFT. The posting on the consumer's monthly checking account statement is a line-item entry for the EFT. No image or image of the check is included in the customer's checking account statement from his or her bank.

In the past, ARC transactions were permitted without the NACHA rules, which requires the payee to "clearly and conspicuously" state that, if the consumer provides a check to the payee, receipt of that check will authorize the payee to use the check to originate an EFT on the consumer's account. This disclosure, usually appearing on the payee's regular billing statement, has sometimes not been very conspicuous, although the NACHA rules require it to be stated prominently. Many consumers have apparently not paid attention to this disclosure, and some have been surprised (or even disinclined to wait) by the recurring ARC

The 2006 Regulation E provision now governs this issue, and goes beyond the NACHA rule by providing model disclosures that indicate that the disclosure be conspicuous.

The FRB also advises that payees consider using headings preceding the model notice, (e.g., call attention to the information presented, and use a print size that is large enough to be noticed.)

Notice in a billing statement or invoice that authorizes ECK should include all of the three model clauses described above, as applicable to the particular situation, (e.g., (1) the ECK notice, (2) the notice that an EFT will be originated in a specific amount for any returned-item charge, and (3) the notice that the EFT may be paid quickly and that the consumer's check will not be returned by his or her bank.

In contrast to a POS transaction where the consumer will receive two forms of notice, the consumer receiving a notice on a billing statement or invoice will get just one notice, so it needs to be clear.

As with POS transactions, it is not necessary for the billing statement to give notice that an EFT may be originated for a returned-item charge if the company does not impose such a charge, or simply adds any such charge to the next invoice. If a company does not电子化 convert checks (i.e., does not use ECK), but does originate EFTs for returned item charges, the ECK disclosure would not be required on a billing statement. If the ECK model statement is used for a returned item charge notice and the first half of model clause (c) would be required.

As with POS disclosures, the requirement to include a model clause (c) is currently set to expire at the end of 2009.

I. Coupon Books

The new Regulation E disclosures for billing statements and invoices must be provided in connection with each payment (in other words, for each statement period). If a payee furnishes payment coupon books, there won't be monthly mailings of a billing statement to the consumer in which to include the ECK procedure and the rule requiring adoption of the model disclosure for closed-end mortgage loans and installment vehicle loans. A coupon book is mailed in advance, often including twelve or more months of closed-end mortgage language payment, if the consumer does not like the ARC, there is usually the option for the consumer to do business elsewhere.

The FRB concluded that it should not be necessary to print the required ECK and other EFT disclosures on each coupon in a coupon book. Instead, the Regulation E disclosures can be given in a noticable location, such as on the first page, or in side the front cover of the coupon book. In this way, a consumer can retain the disclosures, even after coupons are torn out.

Many creditors already had coupon books outing as of the mandatory effective date of the Regulation E changes (January 1, 2007). These creditors were permitted to comply with the new requirements as of the date the creditor first realized the need to include the Regulation E disclosures on coupon book customers, providing the required Regulation E disclosures.

J. Authorization at the POS

The FRB considered whether a merchant can accept an EFT at a POS when the consumer's signed authorization before an ECK would be considered "authorized" for purposes of Regulation E. The FRB decided that a merchant cannot accept an EFT if the consumer says "no" to the ECK or if the consumer indicates that he or she does not want the transaction to be completed. Therefore, if the consumer declines to accept the consumer's payment, the consumer won't be able to complete the transaction (e.g., purchase of goods or services) unless the consumer can pay by an acceptable alternative means, such as cash or a credit or debit card.

K. Authorization on Billing Statements

When consumers mail checks to pay monthly billing statements, invoices, etc., the FRB's approach is much the same as for authorization at the POS. If the ARC payee gives the proper Regulation E notice on the billing statement (as described above), and the consumer proceeds with the transaction (by mailing a check to the ARC payee), the required disclosures together with the mailed check constitute authorization under Regulation E.

If, however, in order to prevent consumers from using their credit or debit card for these transactions as unauthorized under Regulation E's dispute resolution procedure, the merchant is not in compliance with Regulation E's disclosure requirements. The same rule is true for the notice that ARC payees must give on periodic billing statements, if any, that require payment, if the consumer does not like the ARC, there is usually the option for the consumer to do business elsewhere.

With mailed payments that are converted via ARC, the consumer will not receive the check back, will not see a prominently posted notice such as exists at the check-out counter in a POS transaction, and will not be handed a copy of the required notice at the time the check is presented (all of which are supposed to occur in a POS transaction). Instead, the consumer mailing a payment will receive only the notice that is printed on his or her periodic billing statement. The consumer may not realize that ECK or another form of EFT is occurring until the consumer reviews his or her bank statement. The consumer may not realize that ECK or another form of EFT is occurring until the consumer reviews his or her bank statement. The consumer may not realize that ECK or another form of EFT is occurring until the consumer reviews his or her bank statement.

Hence the FRB proposed on December 1, 2006 to eliminate the Regulation E requirement for a written terminal receipt in transactions under $15. The theory is that the monthly deposit account statement provides a sufficient record and confirmation of the transactions, and if the consumer wants more he or she can ask for a copy of the deposit account. If the consumer wants more he or she can ask for a copy of the deposit account.
I. Introduction

This article addresses the Annual Percentage Rate (APR) tolerances for "regular" and "irregular" transactions under the federal Truth-in-Lending Act (TILA) and its implementing regulation, Regulation Z. This distinction is important because, depending on how the transaction is characterized, the transaction may be subject to the more stringent .125 percent tolerance for "regular" transactions or the more lenient .25 percent tolerance for "irregular" transactions. Regulation Z states that, for purposes of determining whether to apply the more lenient .25 percent tolerance, an "irregular" transaction is a transaction that includes one or more of the following features: (1) multiple advances; (2) irregular payment periods; or (3) irregular payment amounts (other than an irregular first period or an irregular first or final payment). The Official Staff Commentary to Regulation Z (Commentary) further explains that this more lenient .25 percent tolerance is intended for more complex transactions that do not fall into a single advance and a regular series of equal payments at equal intervals.

For instance, the Commentary indicates that the more lenient tolerance may be used in a construction loan where advances are made as construction progresses, or in a transaction where payments vary to reflect the consumer’s seasonal income. It may also be used in loans with graduated payment schedules where the contract commits the consumer to several series of payments in different amounts. The Commentary observes, however, that the more lenient .25 percent tolerance would not apply to loans with variable rate features where the initial disclosures are based on a regular amortization schedule over the life of the loan, even though payments may later change because of the variable rate feature.

Conversely, a "regular" transaction is one in which the consumer is given a single advance of funds and is required to make a regular series of equal payments at equal intervals. A "regular" transaction also includes transactions that have irregular first periods, irregular first payments, and irregular final payments. As a result, "regular" transactions that would remain subject to the more stringent .125 percent tolerance would include fixed-rate mortgages with one advance, regular payment periods, and regular payment amounts, as well as adjustable-rate mortgages (ARMs) where the initial disclosures are based on a regular amortization schedule over the life of the loan. Balloon payment loans with otherwise regular payment amounts and periods would also be included in the "regular" transaction category.

II. Application to Discounted Variable-Rate Transactions, Option ARMs and I/O Loans

With respect to variable-rate mortgages where creditors may set initial interest rates that are not determined by the index or formula used to make later interest rate adjustments (i.e., discounted and premium variable-rate transactions), Regulation Z states that because these transactions involve irregular payment amounts, other than irregular first or last payments, these transactions would be considered "irregular" and therefore subject to the more lenient .25 percent tolerance. Significantly, this means that because most current ARM products have a discounted rate, these products qualify as "irregular" transactions and therefore are subject to the more lenient .25 percent of one percent tolerance.

It appears that this would be the case as well with respect to some of the more current "exotic" products in the marketplace, such as option payment ARMs or "interest-only" loans (I/O Loans). For instance, with respect to option payment ARMs, in order to ensure that the borrower is aware of the risk of payment shock that is associated with the products, the disclosed payment schedules should be based on the largest possible finance charge. In an option payment ARM, this would initially be the negative amortization payment option. Once the principal amount of the loan had increased to the negative amortization cap set by the loan documents (e.g.: 110 percent or 115 percent of the original loan amount), and the loan reaches, the negative amortization payment option would no longer be permitted and the disclosed payment schedule under the TILA would reflect the next largest possible finance charge disclosure, which would either be an interest-only payment option or an amortizing payment option. As a result of these multiple disclosed payment schedules, option payment ARMs can contain irregular payment amounts other than the first and last payments and therefore can be considered "irregular" transactions subject to the more lenient tolerance.

With respect to an I/O loan, these products also qualify as "irregular" transactions given the Commentary position on discounted variable-rate transactions. This is because there are two different payment streams that are disclosed with different payment amounts between the I/O period and the fully amortizing period of the loan. As a result, an I/O loan contains irregular payment amounts and therefore qualifies as an "irregular" transaction.

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2. 12 CFR § 226.22(a)(3).
3. 12 CFR § 226.22(a)(3) n. 46.
5. Commentary to 12 CFR § 226.22(c)(3)-1.
6. 12 CFR § 226.22(a)(3) n. 46.
7. Commentary to 12 CFR § 226.17(c)(1)-10(n).