Comments of
National Consumer Law Center
On behalf of its low income clients
to the
California Department of Business Oversight, Legal Division
on
Proposed Rulemaking, Calif. Deferred Deposit Transaction Law (PRO 04/08)

May 19, 2014

Table of Contents

Introduction and Summary

Thank you for the opportunity to respond to the Department's invitation for comments on its proposed rulemaking under the Deferred Deposit Transaction Law. The National Consumer Law Center® is pleased to submit these comments on behalf of its low income clients.

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

In brief, we believe that it would be extremely dangerous to extend the deferred deposit law beyond traditional paper checks or to prepaid cards. Such an extension would also not be consistent with the understanding of the term "personal check" as used in the Deferred Deposit Transaction Law or the purposes of that law.

These comments will focus in particular on the distinctions, both legal and practical, among personal paper checks, remotely created checks (RCCs), remotely created payment orders (RCPOs), ACH transactions, and other types of electronic fund transfers. We will describe the dangers of expanding deferred deposit transactions beyond paper checks and we will note the numerous government enforcement and regulatory efforts aimed at the problems of RCCs, RCPOs, and ACH transactions. We will also describe the distinctions between prepaid and debit cards, and among checking accounts, prepaid card accounts, and checkless checking accounts, and will explain why prepaid cards should not be used for deferred deposition transactions.

Payday loans, prepaid cards, and the law of payment systems are all among NCLC's core areas of expertise. We have commented frequently on proposed consumer protection regulations, both state and federal, in all of these areas. As part of our series of legal treatises on consumer law issues, we publish Consumer Banking and Payments Law, which discusses in extensive detail the laws governing checks, remotely created checks, electronic fund transfers, and prepaid cards, among other topics, as well as Consumer Credit Regulation, which covers payday loans. The treatise also has a section on the intersection of prepaid cards and credit features. We have also issued a number of reports and white papers, including reports on alternatives to payday loans, the history of the 36% rate cap, guidelines for affordable small dollar loans, unemployment prepaid cards, and overdraft fees.

I. Checks Compared to Other Payment Devices

Checks, remotely created checks, remotely created payment orders, and electronic fund transfers have significant differences. Expanding deferred deposit transactions from checks to other payment devices for deferred deposit would result in fewer consumer protections and would be dangerous.

A. Electronic Fund Transfers and Checks Are Two Mutually Exclusive Categories

California's Deferred Deposit Transaction Law (DDTL) permits an advance against a "personal check."[1] That term is not defined in the DDTL. But the term "check" is defined in California's Commercial Code, which codifies the Uniform Commercial Code (U.C.C.) and is the general body of law that regulates and provides protection to checks.[2]

In this day and age, when checks are routinely processed electronically, the differences between checks, electronic check images, and electronic fund transfers can be difficult to understand. The line, however, is clear and bright, even if it is opaque to the outside observer. In short, these are the different types of payments that are processed electronically that sometimes get confused:

- An electronic image of a check – created from an original paper check and processed through the check system – is a "check."
- A "substitute check" is a paper reproduction of an original check.[3]
- A paper check that bounces and is re-presented through the ACH system as a re-presented check entry (RCK) is still a "check" under the U.C.C., even though it is not processed through the check system.[4]
- An electronic fund transfer created from the information on a paper check but processed from the start through the ACH system is an EFT and is not a "check." This type of EFT is often called an "electronic check conversion" (ECC).[5]

---

[1] Cal. Fin'l Code § 23001(a).

[2] Cal. Comm'l Code § 3104(f), codifying U.C.C. § 3-104(f).

[3] 12 U.S.C. § 5002(16).

[4] Although they are processed through the ACH system (and are covered by the NACHA rules that govern the ACH system), the payments originated with a paper check, and thus they are excluded from the definition of an "electronic fund transfer" and are not within the scope of the EFTA. RCKs remain checks under state law.

[5] Even if the consumer makes a payment with a paper check, the merchant, creditor or other payee may in fact process the payment as an ACH payment, which is an EFT, not a check. That is, the payee may take the bank account and routing information from the check and use it to initiate an EFT through the ACH system. The check is destroyed and is never processed through the check system, not even as an electronic image. This can happen at the point of sale, as at a grocery store; in the back office after the check is turned over; at a bill payment location, such as a wireless telephone store; or at a lock box where consumers mail their bills. But the bottom line is that if the payment, from the start, is processed through the ACH system and not the check clearing system, it is an EFT and not a check.

- A remotely created check (RCC) (also called a "demand draft") – a paper check that is processed through the check system but was not created by the consumer or her bank and does not bear a handwritten signature – is a "check," although it may not be a "personal check."
- A remotely created payment order (RCPO) (sometimes called "electronically-created item" or "electronic remotely created check") – an RCC that never existed in paper form and is processed through the check system from the outset as an electronic check image – is generally understood not to be a "check" under the RCC because it was never in paper form.

There are three clear boundaries between checks and EFTs.

First, by definition, an "electronic fund transfer" within the mean of the EFTA and Regulation E excludes payments that originate by "check."[6] An item can be a check or an EFT but not both.

Second, a "check" under the U.C.C. and federal check laws must originate in paper form.[7] Although checks may be converted to electronic images and processed electronically, the Federal Reserve Banks handle electronic check images only if they were created from an original paper check.[8] EFTs, on the other hand, do not originate in paper.

Third, checks are processed – at least at the outset – through the check clearing system; EFTs are not. Often, checks are processed as electronic images, but those images are still processed through the check system. EFTs are processed through entirely different systems. There are many types of EFTs, but the EFTs that are the subject of this rulemaking are automated clearinghouse (ACH) transactions and card transactions. ACH transactions are processed through one of two ACH operators under rules enacted by NACHA-the Electronic Payment Association. Card transactions – including debit cards, prepaid cards, and credit cards – are processed over a card network, usually Visa or MasterCard. Both the ACH system and the card networks are completely distinct from the check clearing system.

A legal opinion rendered on behalf of payday lenders claims that ACH transactions can be both "checks" under the U.C. C. and an EFT protected by the federal Electronic Fund Transfer Act (EFTA).[9] That is wrong. It is one thing to argue that an ACH debit is the functional equivalent of a check. It is quite another to suggest that an ACH debit, other than a re-presented check entry, is a "check" under the

[6] 15 U.S.C. § 1639a(7); 12 C.F.R. § 1005.3(c)(1) [formerly 12 C.F.R. § 2005.3(c)(1)].
[7] Federal Fin'l Inst'ns Exam'n Council, IT Examination Handbook InfoBase – Electronically Created Payment Orders, available at http://ithandbook.ffiec.gov/it-booklets/retail-payment-systems/payment-instruments,-clearing,-and-settlement/check-based-payments/electronically-created-payment-orders.aspx.
[8] Federal Fin'l Inst'ns Exam'n Council, IT Examination Handbook InfoBase – Electronically Created Payment Orders, available at http://ithandbook.ffiec.gov/it-booklets/retail-payment-systems/payment-instruments,-clearing,-and-settlement/check-based-payments/electronically-created-payment-orders.aspx. A "check is a "negotiable demand draft," 12 C.F.R. § 229.2(k)(1), (2), (3), and to be "negotiable," it must have an "promise" or "order," U.C.C. § 3-104(a), both of which be "written." U.C.C. § 3-103(a)(8), (12).
[9] Letter from R. Paul Soter, Jr. to XY Lending (July 22, 2005).

U.C.C. A regulation under the EFTA provides unequivocally: "The term 'electronic fund transfer' does not include: (1) *Checks*."[10]

There is no credible argument that an automated clearing house (ACH) transaction (other than a re-presented check entry), debit card transaction, or any other electronic fund transfer is a "check" within the meaning of U.C.C. or California's codification of it. There is no controversy on this subject.

There is widespread recognition that ACH transactions are not "checks" covered by the U.C.C. A white paper from the Federal Reserve Board of Atlanta notes:

> [A]n ACH debit entry [is] governed by Regulation E and not U.C.C. articles 3 and 4. The check [that provides the information used to create the ACH debit] itself is not a 'check' under check law, but rather is viewed as a source document providing the needed information to originate an electronic funds transfer. 12 C.F.R § 205.3(c)(1) (2006); See also U.C.C. § 4-110, an item needs to have existed at some point for article 4-110 to apply; See also generally, Press Release, Retail Payments Office of the Federal Reserve System from Rich Oliver to Chief Executive Officers at Depository Institutions (June 16, 2008) [hereinafter Oliver Press Release] (on file with author).[11]

It is also widely accepted that, to be a "check," an item must have originated in paper form. Indeed, it is because of this fact that remotely created payment orders are not considered "checks" under federal law and are generally understood to not be covered under the U.C.C.[12] The Atlanta Fed white paper explains that the Federal Reserve Banks:

> …exclude electronic remotely created checks, i.e., those remotely created checks that never take the form of paper, from the warranties the Federal Reserve Banks would otherwise make in the normal course of check collections. [Operating Circular No. 3] clarified that an item does not constitute an 'electronic item' unless the data captured originally derived from a paper check. The Federal Reserve Banks reasoned that because these items never existed as paper checks, they were not recognized under check law. [13]

---

[10] 12 C.F.R. § 1005.3(c)(1).

[11] Ana R. Cavazos-Wright, "An Examination of Remotely Created Checks" at 14 (2009) ("Atlanta Fed Paper") available at http://www.frbatlanta.org/documents/rprf/rprf_resources/RPRF_wp_0510.pdf.

[12] F.T.C. v. Johnson, 2013 WL 800257 at *4, (D. Nev. March 1, 2013) (finding that RCPOs are EFTs, and noting: "Persuasive is a notice issued by the Retail Payments Office of the Federal Reserve to financial institutions that it views transactions like the ones authorized by Elite Debit's protocol as 'electronically originated consumer payments [that] fall under the requirements of the Electronic Funds Transfer Act and Regulation E, not under check law.'").

[13] Atlanta Fed Paper at 12-13 (citing Board of Governors of the Federal Reserve System, Operating Circular No. 3: Collection of Cash items and Returned Checks, §§ 20.10, 21.0 July 2006).

NACHA—the Electronic Payments Association, which promulgates the rules governing the ACH system--is also clear that ACH payments are governed by Regulation E, not the U.C.C.[14]

The banking industry has also recognized that checks must originate in paper. In comments to the Federal Reserve Board, The Clearing House stated:

> Paperless RCCs (RCPOs), while often indistinguishable from Paper RCCs to the depositary bank and to any transferring, presenting or paying bank, have uncertain legal status because, as currently defined under Regulation CC, an RCC must be reduced to paper, if even for a moment, in order to achieve definitional status as a 'check' under federal law.[15]

There is simply no question that ACH payments are not checks under the U.C.C.

There is some slight doubt about RCPOs, because they are check images, are processed through the check system, and cannot be distinguished on the receiving end from other forms of checks. But the only court decision on that point to date found that they are EFTs, not checks.[16] Remotely created checks and remotely created payment orders are discussed in more detail below.

B. Remotely Created Checks are "Checks" But Should Not Be Considered "Personal Checks"; Remotely Created Payment Orders are Unlikely to Be Checks

Remotely created checks (RCCs) are what they sound like: checks that are created at a remote location by a person other than the consumer or the consumer's bank. RCCs are paper checks that look like traditional checks, but they do not bear a handwritten signature of the consumer. Instead of a signature, they carry the words "authorized by the drawer" or similar language.

Under the U.C.C., the definition of "signature" is quite broad and can include the words indicating the consumer's authorization of the check. RCCs can be created, for example, by an internet payday lender after receiving the consumer's authorization. They are deposited into the check system in the same manner and processed in the same manner as traditional signed checks.

Remotely created checks are considered checks within the meaning of the U.C.C. However, it is not clear whether they are "personal checks" within the meaning of California law and the Deferred Deposit

---

[14] *See* NACHA, "Remotely Created Checks and ACH Transactions: Analyzing the Differentiators" at 13 (Appendix A), available at http://www.macha.org/Portals/0/RCC%20White%20Paper%20031110%20Final.pdf.

[15] Robert C. Hunter, The ClearingHouse, Letter to Louise L. Roseman, Board of Governors of the Federal Reserve System, October 28, 2010 Re: Proposed Amendment to Regulation CC to Address Paperless Remotely Created Checks.

[16] F.T.C. v. Johnson, 2013 WL 800257 at *4, (D. Nev. March 1, 2013) (finding that RCPOs are EFTs, and noting: "Persuasive is a notice issued by the Retail Payments Office of the Federal Reserve to financial institutions that it views transactions like the ones authorized by Elite Debit's protocol as 'electronically originated consumer payments [that] fall under the requirements of the Electronic Funds Transfer Act and Regulation E, not under check law.'").

Transaction Law. That term is not defined. Although RCCs are governed by check laws, they pose a number of dangers not presented by traditional checks, discussed in the section below. RCCs are not presented by a person and are not personally signed. Therefore, the Department should rule that RCCs are not "personal checks" that are eligible for deferred deposit.

Remotely created payment orders (RCPOs) are similar to RCCs with one difference: they never existed in paper form. Whereas RCCs are printed out and deposited in paper, RCPOs start as electronic check images that were never paper. While this may sound like an immaterial difference, it has two critical repercussions that make RCPOs even more dangerous than RCCs.

First, because they were never paper, the legal protections that apply to them are unclear. RCPOs do not meet the definition of "check" under the U.C.C. and may not be covered by the laws protecting consumers who use checks. Because they are not "checks" (and do not fit in the exemption for checks), RCPOs should be considered electronic fund transfers protection by the Electronic Fund Transfer Act and Regulation E. Federal regulators have not issued a definitive statement on this point. However, even if they are technically protected by the EFTA, neither consumers nor their banks can distinguish RCPOs from other checks. Therefore, banks do not follow EFTA protections when dealing with RCPOs.

The second ramification of the lack of paper is that RCPOs are easier to produce on a mass scale. They do not need to be printed and physically transported to a bank for deposit. Thus, they are much easier for scammers to use to inflict widespread harm on consumers.

C. RCCs and RCPOs Are Particularly Dangerous Because They Can Evade Even the U.C.C.'s Protections

Remotely created checks are "checks" within the meaning of the Uniform Commercial Code (U.C.C.) and are covered by the same rules. Nonetheless, in practice, those rules are more difficult to enforce for RCCs, and the U.C.C. does not address unique issues that arise with RCCs but not with paper checks.

As noted above, the legal rules that apply to remotely created payment orders are unclear, and banks are unlikely to follow EFTA protections even if they technically apply. To the extent that banks recognize RCPOs as checks and follow check law, the RCPOs pose the same difficulties as RCCs.

RCCs and RCPOs can be very difficult to stop. Under the U.C.C., a consumer who wishes to stop payment of a check must identify the check with "reasonable certainty." Banks typically use the check number and amount to identify a check. With an RCC or RCPO, the consumer will not have a check number and may not know the date or amount. Payday lenders have also been known to manipulate the amount of the RCC or RCPO to evade a stop payment order.

For example, one payday borrower complained:

> After we received [the payday loan], 2 weeks later the first payment was withdrawn automatically from our checking account. Within two and a half months the loan was repaid plus interest, but the payday loan company continued to withdraw money from our checking account. They wouldn't stop taking payments on their end even after I asked them to stop. So I had to do a stop payment at my bank. However even after I did the stop payment, they withdrew money from my checking account by making the amount they were withdrawing 2 cents less than the stop payment amount which was a red flag there.[17]

Payday lenders also use fine print in their contracts to change the form of the payment in order to evade stop payment orders. In recent comments to the Federal Reserve Board asking for a ban on RCCs and RCPOs, we detailed numerous instances of payday lender contracts that permit this practice.[18] If the consumer stops payment of a check or RCC/RCPO, the lender will create an EFT (which, as discussed below, may not be possible to stop).

Stop payment orders may also be ineffective if the consumer does not understand what type of payment it is. Bank systems for stopping payment of checks and EFTs may be separate and not linked. If the consumer enters an order to stop payment of a check, the bank's system may not stop it if it is processed as an EFT. The reverse can happen as well.

The U.C.C.'s rules covering forged and altered checks also do not apply easily to RCCs and RCPOs. With a traditional paper check, the questions are fairly simple: was the consumer's signature forged, and was the amount altered from the amount that the consumer wrote? With an RCC, the questions of forgery and alteration become a question of authorization, with complicated issues about what the consumer understood, what the fine print of a contract permits, and whether the contract was legal in the first place.

With a paper check, there is no need to revoke authorization for subsequent payments. The check is a single payment instrument. With RCCs and RCPOs, if the consumer has authorized, or is purported to have authorized, a series of payments, there are no clear rules governing when the consumer can revoke that authorization and what the payee or the bank must do in response.

D. There Are Significant Gaps in Consumer Protections That Make EFTs Vulnerable to Abuse by Payday Lenders

The federal Electronic Fund Transfer Act and Regulation E that implements it contain a reasonably good set of consumer protections. In some circumstances, these protections are more robust than those provided by the laws governing checks. However, as in the case of RCCs, there are circumstances under which the protections do not work in practice, and there are gaps in the law.

---

[17] http://www.stoppaydaypredators.org/Personal%20victim%20stories.html.

[18] Comments of NCLC et al. to the Federal Reserve Board on Improving the U.S. Payment System (Dec. 13, 2013), available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/rcc-fed-comments12132013.pdf.

Consumers do not have a clear right to stop payment of one-time EFTs. The stop payment rights in the federal Electronic Fund Transfer Act only apply to recurring payments. NACHA rules require banks to stop payment of single entry ACH transactions, but those rules are not directly privately enforceable by consumers. EFTs that are not ACH transactions – such as debit card and prepaid card transactions – are not covered by NACHA rules.

Even for recurring transactions, stop payment rules are not always clear or easy to enforce. Some courts have held that a series of single payment loans are recurring transactions, but others have not.[19] Banks often fail to cooperate with requests to stop payment of recurring EFTs. Despite clear rules requiring banks to stop preauthorized EFTs, in practice we have heard of multiple problems when consumers attempt to stop those payments. The bank may refuse, telling the consumer that she must contact the payee. The bank may stop only the first EFT and fail to stop subsequent ones. The bank may require the consumer to enter a separate stop payment order and pay a separate $35 stop payment fee for each anticipated recurring transaction.

As with RCCs, the consumer may also have difficulty identifying the payee or amount of the anticipated payment in a way that fits with the bank's stop payment system. And, as discussed above, the payday lender may manipulate the amount or form of the payment to evade a stop payment order.

EFTs also pose similar problems to RCCs when questions arise about whether the consumer authorized a particular payment. The EFTA does not contain specific rules governing authorization requirements for one-time EFTs. While the EFTA protects consumers from liability for unauthorized payments, the rules are not as simple as determining whether a check was forged. Here again, complicated issues arise about what the consumer authorized, what the fine print of a contract permits, and whether an authorization is valid if it is part of a contract for an unlicensed or otherwise illegal loan. Banks may refuse to treat a payment as unauthorized if the consumer consented to it in the terms of the contract, even if the consumer did not understand the contract or the contract was illegal.

As with RCCs but unlike paper checks, EFTs can lead to a series of never-ending payments for which authorization is difficult to revoke. NACHA rules give consumers the right to revoke authorization but, again, those rules are not directly enforceable by consumers.

E. Debit Cards and Prepaid Cards Lack Stop-Payment Protections

The role of debit and prepaid cards is generally discussed in the sections below. Payday lenders do not typically take preauthorization for debit or prepaid card payments to secure a payday loan, as they would have to pay the Visa or MasterCard interchange fee. Even where prepaid cards are used as the basis for a payday loan, the lender typically takes preauthorization for an *ACH debit* against the prepaid

[19] *See* NCLC, Consumer Banking & Payments Law § 5.8.1 (5th ed. 2013 & Supp.).

card account (processed in the same manner as an electronic transfer from a bank account) rather than authorization to process the payment over the Visa or MasterCard network.

Indeed, the only use of debit card transactions in the payday loan context of which we are aware involves illegal loans. Some illegal online payday lenders have had their access to the ACH network cut off by the originating banks. In order to collect on outstanding loans, the lenders have called borrowers and asked them to supply a debit (or prepaid) card number.

To the extent that payday lenders do process *debit* card payments over a card network, those payments are EFTS covered by the EFTA but not NACHA rules. Most *prepaid* cards are presently outside the scope of the EFTA. However, most card issuers voluntarily follow the EFTA rules, and the Consumer Financial Protection Bureau is planning a rulemaking to extend coverage.

Although debit cards carry reasonably good consumer protections, there is one place where personal checks may carry better protections. Consumers do not have effective stop payment protections for card transactions. At the point that they are processed through the Visa or MasterCard networks, card transactions are immediately approved and cannot be stopped. Banks will not honor requests to stop payment of a card transaction. Consumers do have the right to demand a reversal of an unauthorized charge, but they cannot prevent the payment from coming through in the first instance and cannot reverse it if it was authorized. Therefore, unlike a traditional deferred check, a consumer who needs funds for more immediate needs like food or medicine has no ability to stop the transaction.

2. Expanding Deferred Deposit Transactions to Remotely Created Checks and Electronic Fund Transfers Would Be Dangerous

A. Remotely Created Checks Should Be Banned, Not Encouraged

The dangers of remotely created checks are so severe that numerous state and federal government agencies, along with consumer organizations, have called for them to be severely restricted or even banned. Canada banned RCCs in 2004.[20] The National Association of Attorneys General has called for their abolition since 2005.[21]

The Federal Trade Commission is presently in the middle of a rulemaking that proposes to ban the use of RCCs in transactions covered under the Telemarketing Sales Rule. If finalized as proposed, that ban

[20] While there is no specific rule or law barring them, the Canadian Payments Authority, which operates Canada's payment clearing system, prohibits their use. Canadian Payments Authority, "Prohibition of Tele-Cheques in the Automated Clearing Settlement System" (June 1, 2003), available at http://www.cdnpay.ca/imis15/eng/Act_Rules/Automated_Clearing_Settlement_System_ACSS_Rules/eng/rul/policy_statement_telecheques.aspx.

[21] National Association of Attorneys General, Comment to the FRB Docket No. R-1226 (Proposed Amendment to Regulation CC/Remotely Created Checks) (May 9, 2005), available at http://www.federalreserve.gov/SECRS/2005/May/20050512/R-1226/R-1226_264_1.pdf.

would cover the use of RCCs in any transaction in which a telephone call is made, including payday loan transactions.

The FTC's compelling discussion of the dangers of RCCs includes examples of purely online transactions.[22] Unfortunately, the FTC does not have the same rulemaking authority over internet transactions as it does over those under the Telemarketing Sales Rule.

In the last few years, the case for abolishing RCCs has become even more compelling as ACH transactions are now available in situations where RCCs were being used, and the evidence of abuses of RCCs has become overwhelming.

This past, December, the National Consumer Law Center (on behalf of its low income clients), Consumer Federation of America, Center for Responsible Lending, Consumer Action, Consumers Union, National Association of Consumer Advocates, National Consumers League and U.S. PIRG all called on the Federal Reserve Board to ban RCCs and RCPOs completely in consumer transactions. Our organizations have seen widespread use of RCCs and RCPOs to evade consumer protections, to compromise consumers' control over their bank accounts, and to facilitate unlawful, fraudulent, unfair, deceptive and abusive practices. RCCs and RCPOs should be banned because:

- They are too easy to use to debit bank accounts without consumer consent;
- They lack the consumer protections available for other electronic payment methods;
- They operate through the check clearing system, which lacks the systemic controls to police fraudulent and unlawful use;
- They are widely used to facilitate fraudulent and unlawful payments and to evade consumer protections and oversight;
- They are unnecessary in light of the wide availability of modern electronic payment systems;
- Their usefulness for a handful of legitimate uses is outweighed by their risks, and legitimate users can easily move to alternatives that are less susceptible to abuse;
- A clean, complete ban will facilitate legal compliance.

Our detailed letter to the Federal Reserve Board describing the dangers of RCCs and RCPOs is attached as Exhibit 1 to this letter and is incorporated in these comments. RCCs also pose all of the problems that ACH transactions pose, as discussed in the next section.

RCCs should be banned, not encouraged. The Department should not authorize use of RCCs in deferred deposit transactions.

---

[22] Federal Trade Commission, Notice of Proposed Rulemaking, 16 CFR Part 310, Telemarketing Sales Rule, 78 Fed. Reg. 41200 (July 9, 2013), available at http://www.ftc.gov/sites/default/files/documents/federal_register_notices/2013/07/130709tsrfrn.pdf.

B. Neither RCCs nor Electronic Fund Transfers Work Well in the Deferred Deposit Context and Both Have Been Frequently Abused

The proposal to permit use of remotely created checks and electronic fund transfers (EFTs) as the basis for a transaction under the Deferred Deposit Transaction Law would expose California consumers to multiple dangers. Although EFTs[23] have many legitimate uses and are monitored more closely than RCCs, they do not work well in the context of deferred deposit transactions and expose consumers to multiple dangers.

As discussed above, in the deferred deposit context, paper checks do not present the same problems as RCCs and EFTs do with respect to the practical and, at times, legal ability to:

- Stop payment ;
- Contest a forged or unauthorized payment;
- Prevent multiple, ongoing future debits.

These are more than technical issues. Expanding deferred deposit beyond traditional, signed paper checks poses risks of both consumer understanding and abuse by predatory lenders and scammers.

The act of writing a personal paper check is very conscious and deliberate. The consumer herself creates the payment instrument, writing out the name of the payee, the amount, the date, and deliberately signing her name. The check authorizes a payment from a specific identified account. Each of those key elements is fully known to the consumer.

A paper check authorizes only a single payment. The check can only be used once to repay a single advance and cannot be used again and again to debit the consumer's bank account. If the consumer wants to enter into another deferred deposit transaction, she must do consciously by writing out a new check.

Consumers understand how checks work. They know how they are deposited, how to stop them, and what will happen if the account does not have sufficient funds.

Paper checks are also very unlikely to be forged. We have never heard of a single instance of a payday lender forging a traditional paper check that the consumer did not write and sign.

RCCs and EFTs, on the other hand, are much easier to create without a consumer's full understanding and with uncontrolled repercussions. The consumer does not herself write out the name of the payee, the amount, the date on which it can be deposited or her signature.

[23] This section focuses on ACH transactions, since they are the primary form of electronic fund transfer that is likely to be used for deferred deposit transactions. Debit and prepaid card transactions are (or soon will be) EFTs as well, but they are more costly for lenders and are less likely to be used. Card transactions are discussed in the section below.

Fine print in the contract may purport to authorize multiple debits against the consumer's account with a single authorization. A single authorization may be obtained to withdraw both a fee for the deferred deposit and the repayment of the original advance, and the consumer may have no idea how much will be withdrawn and when.

Once a company has a consumer's bank account and routing number, it has all it needs to create multiple debits from the consumer's account, authorized or unauthorized. It is very hard for the consumer to control what happens with that information.

We have found that some online payday lenders may be using the fine print of contracts to obtain purported authorization to debit *any* bank account that the lender may discover in the future, not only the one account against which the consumer has authorized a payment. For example, Just Military Loans states:

> Collection and Use of Bank Account Information: If we extend credit to you, we will consider the bank account information provided by you as eligible for us to process payments against. In addition, as part of our information collection process, we may detect additional bank accounts under your ownership. We will consider these additional accounts to be part of the application process.[24]

Similar language is included in the privacy policies posted by the online lender American Web Loan.[25]

While even paper check based deferred deposit transactions are harmful to consumers, use of ACH entries and RCCs for payday loans exposes consumers to even greater dangers of unlimited overdraft and NSF fees and the risk of losing their bank accounts. When consumers cannot control future debits that they did not knowingly authorize, and do not know when, whether or in what amount another debit will come in, they completely lose control of their bank accounts.

The repercussions for consumers' bank accounts are compounded by the fact that banks frequently are uncooperative or have inadequate systems for stopping ACH entries and RCCs. These dangers were illustrated in a recent case against JP Morgan Chase.[26] Chase refused the plaintiffs' repeated requests to stop the lenders from debiting their accounts, and then charged them repeated insufficient fund or returned-item fees. Chase had also refused their requests to close their accounts, claiming that it could not close the accounts if transactions were pending or if the accounts carried a negative balance. In one case, Chase charged the plaintiff more than $800 in overdraft fees and seized more than $600 in child

---

[24] www.justmilitaryloans.com/why-choose-just-military-loans/privacy-policy/ (viewed 5/18/14).

[25] https://www.americanwebloan.com/privacy (viewed 5/18/14).

[26] The facts of the case are described in Jessica Silver-Greenberg, New York Times, "Major Banks Aid in Payday Loans Banned by States" (Feb. 23, 2013), available at http://www.nytimes.com/2013/02/24/business/major-banks-aid-in-payday-loans-banned-by-states.html?pagewanted=1&_r=0.

support benefits belonging to her minor child to cover the fees. Chase charged another plaintiff $1,523 in fees — a combination of 44 insufficient fund fees, extended overdraft fees and service fees – after it permitted internet payday lenders to attempt to debit her account 55 times over a two-month period despite her efforts to close the account. We have heard similar stories from other banks.

State and federal authorities have been struggling to go after multiple online payday lenders who use RCCs and ACH transactions. These lenders frequently do not have state licenses, do not follow state law, and use RCCs and ACH transactions to entrap consumers into an ongoing series of debits that they did not knowingly authorize.

The U.S. Department of Justice recently brought an enforcement case against a bank that was using RCCs and ACH debits to facilitate illegal and deceptive online payday lending.[27] The bank ignored numerous signs that the payments were in in violation of state law. Consumers who believed that they had authorized only a single withdrawal from their bank accounts found that they were debited repeatedly and could not make the debits stop. RCCs and EFTs make this type of conduct possible.

The Federal Trade Commission has pursued numerous cases against internet payday lenders that used ACH and RCC transactions.[28] The lenders often violate the Electronic Fund Transfer Act by requiring consumers to authorize EFTs as a condition of credit. Numerous FTC cases also document the deceptive use of ACH entries and RCCs by payday lenders.

Legitimizing preauthorized RCCs and ACHs by online lenders also risks exposing consumers to identity theft. In order secure repayment by these devices, lenders require the consumer to provide their bank account and routing number.[29] Consumers often cannot distinguish between the website of a lender and the website of a lead generator that is merely collecting personal financial information for sale to the highest bidder. The FTC has pursued cases against scammers posing as debt collectors for loans that were never made.[30]

We know that the Department is well aware of the dangers of illegal internet payday lending. The Department has issued numerous warnings to consumers about those dangers of such loans and about efforts to collect illegal debts.

[27] United States v. Four Oaks Fincorp, Inc., et al., No. 5:14-cv-00014-BO (E.D. N.C. Jan. 8, 2014), available at http://www.courthousenews.com/2014/01/09/USvFourOaks.pdf.
[28] A number of FTC cases through August 2013 are available at http://www.consumerfed.org/pdfs/Studies.IPDL.FTC.Actions10.30.12.pdf.
[29] Requiring preauthorized electronic payment may violate the Electronic Fund Transfer Act, 15 U.S.C. 1639k, but payday lenders use a variety of devices to get around the ban on compulsory use of electronic payments.
[30] *See* FTC, Press Release, "Court Halts Alleged Fake Debt Collector Calls from India, Grants FTC Request to Stop Defendants Who Posed as Law Enforcers" (Apr. 11, 2012), available at http://www.ftc.gov/news-events/press-releases/2012/04/court-halts-alleged-fake-debt-collector-calls-india-grants-ftc.

But two points are important in the context of the current proposal. ***First, the dangers of RCCs and EFTs when used for deferred deposit transactions occur even if the lenders are licensed and the loans comply with the terms of California law.*** The instruments still pose the danger of automatic rollovers that the consumer did not knowingly authorize and the difficulty of stopping payment, revoking authorization, and challenging or preventing unauthorized transactions.

Second, the Department's efforts to protect the public and inform consumers will be much more effective if the Department can announce a clean line: In California, deferred deposit transactions may only be made with a traditional paper check. Once RCCs and EFTs are authorized as a payment method, it will be difficult for consumers to understand or spot the difference between a legal and an illegal loan. The Department will also have a difficult time enforcing its laws and preventing consumers from being deceived and losing control over their bank accounts.

3. Debit and Prepaid Cards are not Personal Checks

The Department has asked two questions about the distinctions between different types of cards. First, what is the difference between "debit card-accessed demand deposit account," "prepaid debit card-accessed demand deposit account," and "general-purpose prepaid debit card-accessed demand deposit account"? Second, are those products a "personal check" under the California Deferred Deposit Transaction Law?

The terms quoted above are not terms in general use. In short, there are only two types of cards at issue here: debit cards and prepaid cards, and neither is a personal check.

A "debit card" is generally a card used to access funds in a demand deposit account. A demand deposit account is a bank account in an individual's name (i.e., in cardholder's name) that can be access on demand – typically by a check, but also by other devices such as a debit card or by ACH transactions.

Some demand deposit accounts do not have checks and can be accessed only through debit card and ACH transaction. If the account is in the cardholder's name (as opposed to being a subaccount of a master account), then it is still an individual demand deposit account and not a prepaid card account. These accounts are informally referred to as "checkless checking accounts." Both traditional checking accounts and checkless checking accounts are demand deposit accounts, and both have debit cards.

A "prepaid card" (sometime also called a debit card) is a card used to access funds in a prepaid card account, which is subaccount of a larger master account that is not in the cardholder's name. The term "prepaid card" sometimes refers to the card itself and sometimes to the underlying account. The master account is in the name of the program manager that provides the cards – i.e., Green Dot, NetSpend, or American Express. The subaccount is in the consumer's name. A "general purpose reloadable card" (GPR card) is a type of prepaid card that can be used widely – i.e., anywhere that Visa and MasterCard are accepted – and is reloadable (i.e., is not a single load gift card). The term "GPR card" does not necessarily encompass payroll cards and government benefit prepaid cards that function similarly but are obtained in a different manner and may not be reloadable with funds other than wages or benefits.

A prepaid card account is not an individual demand deposit account and is not a checking account. Both the EFTA and Regulation E define the types of "accounts" that are protected by those rules to include "demand deposit" accounts.[31] But prepaid card accounts are not presently encompassed within that definition or covered by the EFTA or Regulation E.

Prepaid card accounts can always be accessed by the card over the card networks. Some but not all cards can be accessed by ACH transaction. Some cards have bill payment features that enable the consumer to set up an electronic payment over the ACH system, in a similar manner as with bank account bill payment services, but the funds are set aside at the time the consumer arranges the payment.

A smaller subset of cards permits an outside third party to submit an ACH debit against the card pursuant to a preauthorization by the consumer. The prepaid card account has an underlying bank account and routing number (not disclosed on the card itself) that can be used for an ACH transaction that either debits the account (i.e., to pay the monthly telephone bill) or credits it (i.e., for direct deposit of wages or benefits).

Many cards do not permit incoming ACH debit entries, even if the account has sufficient funds. The ACH entry would be rejected if it came in. However, prepaid cards offered by payday lenders do permit ACH transactions. As discussed below, those cards also often have overdraft fees.

Payday lenders who wish to use prepaid cards to secure payday loans are mostly likely to use preauthorized ACH debits against a prepaid card account rather than to use the card itself. ACH transactions are processed through the ACH system, which is completely different from the Visa and MasterCard networks that are used to process card transactions when the card or the card number is used directly. Although payday lenders could use the card or the card number, they are less likely to do so because they would need to pay interchange fees to the card issuer.

ACH transactions from prepaid cards are authorized by consumers in the same manner as ACH transactions from banking accounts, and the same dangers of unauthorized use exist. In addition, prepaid cards presently fall in a crack in the Electronic Fund Transfer Act. Although the transactions otherwise meet the definition of "electronic fund transfer," they fall out of the definition because, at the present time, most prepaid card accounts are not "accounts" within the scope of the EFTA. The Consumer Financial Protection Bureau is preparing a rulemaking to bring the cards within the EFTA's scope.

---

[31] 15 U.S.C. § 1639a(2); 12 C.F.R. § 1005.2(b)(1).

Neither ACH transactions nor card transactions that draw from prepaid card accounts are "checks" within the meaning of California law or the U.C.C. for the same reasons described above for ACH and card transactions generally. The same is true of ACH or card transactions from checkless checking accounts. Neither ACH transactions nor card transactions fit the legal definition a check, originate in paper, or are processed over the check clearing system.

4. Prepaid and Checkless Checking Accounts Should Not be Used to Secure Deferred Deposit Transactions

In addition to the reasons described above, there is another important reason why ACH and card transactions should not be considered "paper checks": consumers turn to those accounts precisely to avoid the dangers posed by paper checks. Permitting payday loans to be secured by a preauthorized ACH transaction from a prepaid or checkless checking account would expose the consumer to the potential for overdrafts and overdraft fees.

Prepaid cards, in particular, are marketed to consumers as a way of avoiding overdraft fees, gaining control over their finances, and gaining access to a deposit account when the consumer is ineligible to obtain a bank account. Prepaid cards do not have checks for a reason.

The same is true of many checkless checking accounts. By eliminating the checks, the bank can also eliminate the overdraft fees and offer the accounts as "second chance" accounts to consumers who have had difficulties with traditional checking accounts. For example, Bank of America's new "SafeBalance" account is offered to consumers "who want more predictability in the way they bank and added protection against overdrafts."[32]

As noted above, most prepaid cards will not even work for deferred deposit transactions because they do not permit preauthorized ACH debit transactions. If the consumer provided the underlying routing and bank account number to a payday lender, the payment would be rejected even if there were funds in the account. This is a legal requirement of any card issued by a bank with over $10 billion in assets (i.e., the Chase Liquid card)[33] and is a policy of the biggest prepaid card issuer, Green Dot.

However, prepaid cards offered by payday lenders do permit ACH transactions *and* often charge overdraft fees. For example, the ACE Cash Express Elite Visa Prepaid Card[34] and the Purpose Card

---

[32] Danielle Douglas, "How Bank of America is killing the paper check," Washington Post (Mar. 7. 2014), available at http://www.washingtonpost.com/blogs/wonkblog/wp/2014/03/07/how-bank-of-america-is-killing-the-paper-check/.

[33] Banks that are covered by the interchange fee cap of the "Durbin amendment" may nonetheless issue prepaid cards that charge higher interchange fees than permitted by the cap if the funds may only be accessed through a card transaction and not through an ACH transaction, check or other vehicle.

[34] *See* NetSpend, "Your Guide to Getting Started Today" at 6, available at https://www.aceelitecard.com/account/terms/2013_ACE_Meta_Visa_TCs_Dec3.pdf.

offered by Advance America[35] – both provided by NetSpend – offer opt-in overdraft "protection" that triggers a $15 overdraft fee if a transaction is overdrawn. The service is only available if the consumer arranges direct deposit to the card, and the overdraft amount plus the fee are deducted from the next deposit of wages or benefits. Overdraft "protection" can add $15 to the cost of every deferred deposit transaction that is processed against a prepaid card account that has insufficient funds to cover it.

In addition to overdraft fees, a prepaid card with ACH capacity also can be exposed to the same dangers of repeated, uncontrollable debits described above. These problems hit especially hard on prepaid card holders, who are vulnerable consumers with low incomes and low credit scores who have often been shut out of bank accounts due to problems with overdraft fees. [36] Thus, permitting deferred deposit transactions to be based on a prepaid card is especially dangerous.

In order to keep prepaid cards safe, a broad coalition of organizations has urged the Consumer Financial Protection Bureau to ban overdraft fees and credit features on prepaid cards.[37] Our comments explain at length the dangers of linking prepaid cards and credit products.[38] As part of such a ban, we have urged the CFPB to prohibit payday lenders and others from using a preauthorized payment from the card as a condition of the loan.[39]

California should not be taking a step backwards in the efforts to protect prepaid cards by authorizing their use in deferred deposit transactions. Prepaid cards need to be a safe refuge for those who cannot turn to bank accounts.

---

[35] *See* https://www.advanceamerica.net/services/details/visa-prepaid-cards and http://www.gowithpurpose.com/features#overdraft.

[36] A Pew survey found that prepaid card users who use the cards at least monthly have lower incomes than the general population and are more likely to earn less than $25,000. Pew Charitable Trusts, "Why Americans Use Prepaid Cards" at 3-4 (Feb. 2014), available at http://www.pewstates.org/uploadedFiles/PCS_Assets/2014/Prepaid-Cards-Survey-Report.pdf. The vast majority of new Chase Liquid customers had no bureau score or a score below 660 when they opened their Chase Liquid account. Presentation by Jon Wilk, Chase, to FDIC Committee on Economic Inclusion, available at http://www.fdic.gov/about/comein/2013/2013-05-16_presentation_wilk.pdf (hereinafter "Liquid ComE-In Presentation."

[37] *See* Comments of Americans for Financial Reform, et al., to CFPB on General Use Reloadable Prepaid Cards, Docket No. CFPB-20120019, RIN 3170-AA22 (July 23, 2012), available at http://www.nclc.org/images/pdf/rulemaking/comment-prepaid-shorter-july2012.pdf.

[38] *See* Comments of NCLC et al., to CFPB on General Use Reloadable Prepaid Cards, Docket No. CFPB-20120019, RIN 3170-AA22 at 3-42 (July 24, 2012), available at http://www.nclc.org/images/pdf/rulemaking/cm-prepaid-card-july2012.pdf.

[39] *See* NCLC, "Keep Prepaid Cards and Credit Products Separate" at 3-4 (July 2013), available at http://www.nclc.org/images/pdf/high_cost_small_loans/ib-prepaid-and-credit-dont-mix-july-2013.pdf.

5. Expanding the Use of Deferred Deposit Transactions Would Undercut the California Finance Lenders Law

The Departments asks if permitting use of electronic fund transfers, debit cards, prepaid debit cards, or remotely created checks to constitute a "personal check" would eliminate the distinction between deferred deposit transactions and small dollar short-term loans subject to the California Finance Law. The answer is "yes."

Deferred deposit transactions were exempted from the protections that generally apply to small dollar loans in California for two reasons. First, the transactions are structured as merely a fee for cashing – and deferring the deposit of -- a check rather than as a loan. Second, the transactions are individually of very short duration, only 14 days, and that short duration was used to justify exempting them from the cap on the interest rate that consumers pay when they are in longer term debt.

Permitting payment instruments other than personal paper checks to be used for deferred deposit transactions is inconsistent with both of these rationales for not subjecting the transactions to the protections for other small dollar loans. Without a check, the transaction is certainly not for a "deferred deposit" or a fee for cashing a check. Second, as described above, the other payment instruments are more easily used to extend the term of the transaction beyond the initial 14 days without the need for the consumer to affirmatively enter into a new transaction. For both reasons, without paper checks, the transactions are undisputedly loans that need the protections of the California Finance Lenders Law.

6. "Pinging" Can Help Consumers Avoid Overdraft or NSF Fees

We generally agree that licensees should be required to ping the borrower's bank account before depositing the check (and, if allowed, before processing an EFT). Licensees do not do proper underwriting to confirm ability to pay and target borrowers who have impaired credit. The high fees for the transactions already impose a considerable burden on borrowers, but the possibility of overdraft and NSF fees makes the transactions even more harmful. Those fees can snowball if repeated attempts are made to deposit a check. Overdrawn transactions and repeated overdraft and NSF fees can also lead to account closures and lead a consumer to become unbanked.

Thus, pinging should be required if it can be done in a manner that does not trigger any fees on the consumer. We are unaware of any hardships that pinging accounts would impose on consumers.

However, we urge the Department to collect more information about the different forms that pinging can take and to ensure that it will not harm consumers. For example, one form of pinging might involve submitting a tiny debit entry (i.e., $0.25). At some banks, such a tiny charge would not trigger an NSF or overdraft fee, but at some banks it might.

7. Conclusion

Electronic fund transfers and remotely created payment orders do not meet the legal definition of "check" and should not be considered to be personal checks permitted as the basis for a deferred deposit transaction. Opening up deferred deposit transactions beyond paper checks exposes consumers to numerous dangers and changes the deferred deposit statute into a vehicle for evading the Consumer Finance Law and extending high rate loans that last more than 14 days. Permitting payday loans secured by a payment from a prepaid card is particularly risky, jeopardizing the safety of accounts used by consumers shut out of the banking system and exposing them to the overdraft fees that they are seeking to avoid.

Thank you for the opportunity to submit these comments. If you have any questions, please do not hesitate to contact me at (202) 595-7845 or lsaunders@nclc.org.

Yours very truly,

Lauren K. Saunders
Associate Director
National Consumer Law Center
(on behalf of our low income clients)