



CBA Regulatory Compliance Bulletin

January 23, 2017

Content of an Authorization to Originate Recurring ACH Debit Entries

This article was written by Ted Teruo Kitada,¹ Senior Counsel with Wells Fargo Bank and Chairman of CBA's Legal Affairs Committee.

Background

Under a "Stipulation and Consent to the Issuance of a Consent Order," dated December 16, 2016, Military Credit Services, LLC ("Respondent") stipulated to the issuance of a consent order² ("Consent Order") by the Consumer Financial Protection Bureau ("CFPB") against it, dated December 20, 2016, regarding, *inter alia*, Respondent's consumer lending and debt collection practices. Respondent is a financing company that extends revolving credit to consumers and through a commonly owned company collects debts owed under consumer contracts with Respondent.³ From January 9, 2015, to December 20, 2016, the period covered under the Consent Order, Respondent offered revolving credit arrangements to consumers containing an "ACH Pre-Authorization Payments Agreement," hereinafter "Preauthorization Agreement," to facilitate

electronically the collection of payments arising under the arrangements.

Under this Preauthorization Agreement, Respondent obtained consumers' bank account numbers and withdrew monthly payments from consumers' deposit and credit accounts throughout the term of the credit arrangements. Specially, the Preauthorization Agreement contained the following debit authorization to enable Respondent to collect payments under the credit arrangements, with emphasis added:

I (we) hereby authorize [Respondent] to use my Credit Card ... or my Visa/MasterCard Check Card, or my (our) checking or savings account (identified below) to pull my (our) monthly payment. The depository named below is also authorized to charge the same to my (our) account...; and *Payments must be drafted on or before the contractual due date* and may be subject to a \$25.00 service charge for all non-sufficient funds...⁴

Analysis

According to the Consent Order, Respondent's practice described above violates federal law.

¹ Mr. Kitada may be reached at 415-396-5461.

² A copy of the Consent Order is available at the following link:

http://files.consumerfinance.gov/f/documents/201612_cfpb_MilitaryCreditServices-consentorder.pdf

³ Consent Order, p. 3.

⁴ Consent Order, p. 5.

The practice also raises compliance questions under a clearing house rule.

Violation of federal law. As detailed in the Consent Order, the Preauthorization Agreement failed to comply with federal law. To the extent a consumer's deposit account is subject to a debit under the Preauthorization Agreement, these bank account withdrawals are preauthorized debit entries covered under the federal Electronic Fund Transfer Act ("EFTA") and Regulation E issued under this law, as "electronic fund transfers." The EFTA and Regulation E require any agreement governed thereunder, including the Preauthorization Agreement, to be clear and readily understandable to consumers.⁵ Under the Consent Order, the CFPB ruled that the Preauthorization Agreement provisions detailed above were not clear and readily understandable to consumers because they merely provide that the transfer will be made "on or before the contractual due date." As discussed in more detail below, the Preauthorization Agreement apparently failed to stipulate the amount and date of payment, among other shortcomings, at least as to the provisions shown in the Consent Order.

While the Consent Order curiously fails to raise this point, Respondent could also be in violation of Regulation E § 1005.10(d)(1), if it does not provide a notice varying in amount with respect to payments due under a revolving credit arrangement:

⁵ 15 U.S.C. § 1693c; 12 C.F.R. part 1005, Supp. I, Official Staff Interpretations, § 1005.10(b)-6:

Requirements of an authorization. An authorization is valid if it is readily identifiable as such and the terms of the preauthorized transfer are clear and readily understandable.

When a preauthorized electronic fund transfer from the consumer's account will vary in amount from the previous transfer under the same authorization or from the preauthorized amount, the designated payee or the financial institution shall send the consumer written notice of the amount and date of the transfer at least 10 days before the scheduled date of transfer.

Additionally, for payments varying in amount, Respondent may in lieu of the above notice employ the options in Regulation E § 1005.10(d)(2):

The designated payee or the institution shall inform the consumer of the right to receive notice of all varying transfers, but may give the consumer the option of receiving notice only when a transfer falls outside a specified range of amounts or only when a transfer differs from the most recent transfer by more than an agreed-upon amount.

The Consent Order is unclear whether Respondent failed to comply with these additional federal regulatory requirements as well; however, given the paucity of terms under the Preauthorization Agreement, we may remain skeptical.

Violation of the NACHA Operating Rules. In addition to the requirements for an authorization under the EFTA and Regulation E, an electronic payment through the automated clearing house ("ACH") is subject to the National Automated Clearing House Association Operating Rules and Guidelines ("Operating Rules"), 2017 edition. At

Operating Rules subsection 2.3.2.3(b), an authorization must:

(b) have clear and understandable terms. A purported authorization that is not clear and readily understandable as to its terms (including the amount or timing of debits), or that is otherwise invalid under applicable Legal Requirements, does not satisfy the requirements of this Section 2.3;...

Thus, not only does the Preauthorization Agreement fail to satisfy the requirements for an authorization under the EFTA and Regulation E, it likely fails to satisfy the Operating Rules authorization requirements because it too presumably is not clear and readily understandable as, among other reasons, it does not include the amount and timing of the debits.

In order for Respondent, as Originator, to originate an entry against a consumer's account, as Receiver, the Operating Rules at § 2.3.1 require the Originator to obtain an authorization in conformity with the requirements of the Operating Rules from the Receiver. Under the Operating Rules at § 2.2.2(b), an Originator must agree to be bound by the Operating Rules. This authorization requirement applies to both ACH debits against a consumer's deposit account, but also debits against a consumer's credit account. In contrast, the requirements under the EFTA and Regulation E apply to a deposit or other asset account, but not to a credit account. In regard to the content of an authorization under the Operating Rules, that content may turn in part on the specific ACH entry at issue. Please look, for example, to the Operating Rules at OG22 setting forth in comprehensive

detail the requirements applicable to a single or recurring PPD debit or credit entry. A PPD debit or credit entry is a "Prearranged Payment and Deposit" by an organization against or to a consumer's account. For a PPD authorization granted by a consumer under the Operating Guidelines within the Operating Rules, it must comply with the following:

AUTHORIZATION REQUIREMENTS

As with any ACH transaction, the Originator must obtain the Receiver's authorization to initiate PPD entries through the ACH Network to the Receiver's account. For PPD debit entries, the authorization must

1. be in writing;
2. be readily identifiable as an ACH authorization;
3. have clear and readily understandable terms;
4. provide that the Receiver may revoke the authorization only by notifying the Originator in the manner specified in the authorization; and
5. be either signed or similarly authenticated by the consumer. (Refer to the discussion below on the use of the similarly authenticated standard with PPD entries.)

The Originator must provide the Receiver a copy of the authorization for all debit entries.

For credit entries to a consumer's account, the authorization may be obtained in writing, or it may be

obtained orally or by other non-written means.⁶

As demonstrated from the terms of the Operating Rules, the authorization granted by a consumer in favor of an Originator, including a creditor, must contain significantly more detail under the Operating Guidelines than merely the amount and date of the anticipated debits as provided under Operating Rules subsection 2.3.2.3(b) cited above applicable generally to all authorizations.

Conclusion

When a creditor obtains an authorization from a consumer debtor to debit through the ACH system the consumer's deposit or credit account, in light of this Consent Order, the creditor is encouraged to review carefully the terms of the written authorization to confirm that the requirements under federal law and the Operating Rules are satisfied, particularly stipulating the amount and timing of the regularly recurring debit entries. The failure to comply with this mandate may be costly: under the Consent Order, Respondent is required to pay a civil money penalty of \$200,000.00 to the CFPB.

⁶ Note the distinct difference between an authorization applicable to a PPD debit entry vis-à-vis a credit entry.

This civil money penalty raises an interesting question in light of the relevant period under the Consent Order running from January 9, 2015, to and including December 20, 2016, the effective date of the Order. On October 11, 2016, the D.C. Circuit issued a decision in *PHH Corporation, et al. v. Consumer Financial Protection Bureau*, 839 F.3d 1 (D.C. Cir. Ct. of App., October 11, 2016), which held at pages 50-55, among other things, that the CFPB's administrative enforcement actions are subject to the statute of limitation of the applicable consumer financial law. In this case, the EFTA has a one-year statute of limitations from the occurrence of the violation.⁷ With the period under the Consent Order running nearly two years, it would appear that the CFPB is not following the holding in *PHH Corporation*.

The information contained in this CBA Regulatory Compliance Bulletin is not intended to constitute, and should not be received as, legal advice. Please consult with your counsel for more detailed information applicable to your institution.

⁷ 15 U.S.C. § 1693m(g). The Consent Order also cites a violation of the Truth in Lending Act ("TILA") and its implementing regulation, Regulation Z, by Respondent. The apparent inadequacy of Respondent's account-opening disclosures required under TILA and Regulation Z prompted the issuing of the Consent Order by the CFPB. TILA similarly has a one-year statute of limitations. 15 U.S.C. § 1640(e).



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