FINTECH LAW REPORT
E-Banking, Payments & Commerce in the Mobile World
March/April 2016 ▪ Volume 19 ▪ Issue 2

FTC BANS PAYMENT METHODS UNDER ITS TELEMARKETING SALES RULE

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On November 18, 2015, the Federal Trade Commission (FTC) issued final amendments to the Telemarketing Sales Rule (TSR) banning payment methods that the FTC believes are disproportionately used by scammers (Final Rule). The Final Rule was published in the Federal Register on December 14, 2015.[1]

The Final Rule follows the notice of proposed rulemaking (NPRM) that the FTC published on July 9, 2013.[2] The Final Rule makes some modifications to the proposed amendments to the TSR that were included in the NPRM, but largely adopts the NPRM proposal to ban certain specific types of payment methods in both inbound and outbound telemarketing.

In this article, we will first provide background on the Telemarketing and Consumer Fraud and Abuse Prevention Act (Telemarketing Act) and the TSR promulgated by the FTC pursuant to the Telemarketing Act. We will then briefly describe the FTC's NPRM. Finally, we will discuss the Final Rule and analyze the impact of the changes to the TSR on financial service providers.

Background: The Telemarketing Sales Rule

Congress enacted the Telemarketing Act in 1994 to target deceptive or abusive telemarketing practices. The Telemarketing Act directed the FTC to issue a rule defining and prohibiting deceptive and abusive telemarketing practices. The Telemarketing Act also authorized state attorneys general and other state officials, as well as certain private citizens, to bring civil and enforcement actions in federal district court.[3]

The FTC promulgated the original TSR in 1995 and subsequently issued amendments to the TSR in 2003, 2008 and 2010. As amended, the TSR applies to virtually all telemarketing activities that are conducted to induce the purchase of goods or services or charitable contributions by use of one or more telephones, which involve more than one interstate phone call.

The Telemarketing Act states that the FTC's jurisdiction to enforce the TSR is coextensive with the FTC's jurisdiction under Section 5 of the Federal Trade Commission Act (FTC Act). Under the FTC Act, the FTC does not have jurisdiction over banks, savings and loan institutions and certain federal credit unions. Consequently, the FTC does not have authority to impose limits on such entities under the TSR.[4]

The FTC has described the TSR as "fundamentally an anti-fraud rule that protects consumers from deceptive and abusive telemarketing practices."[5] To that end, the TSR, among other things:[6]

- Requires telemarketers to make certain disclosures to consumers;
- Prohibits telemarketers from making material misrepresentations;
- Requires that telemarketers obtain the "express informed consent" of a consumer before charging a consumer account;
- Requires that telemarketers obtain the "express verifiable authorization" of a consumer before billing the consumer through any payment system other than a credit card or debit card;
- Prohibits a telemarketer from receiving an advance payment for providing services to recover losses incurred as a result of prior telemarketing transactions;
- Prohibits credit card laundering and other forms of assisting or facilitating sellers or telemarketers engaged in violations of the rule; and
- Establishes a national do not call registry and prohibits telemarketers (with certain exceptions) from calling numbers included in the registry, and also limits the use of pre-recorded messages and predictive dialers.

The Notice of Proposed Rulemaking

The FTC published its NPRM on July 9, 2013. The NPRM proposed to prohibit the use of four payment methods which the FTC described as "novel" in connection with telemarketing:

- Remotely created checks, which are created by the payee with information provided by a consumer and are processed through the check clearing system as checks;
- Remotely created payment orders, which are electronic versions of remotely created checks;
- Cash-to-cash money transfers, where a consumer makes a payment in cash that is picked up by the payee in cash at another location; and
- Cash reload mechanisms, where a consumer purchases a reload to a prepaid card, provides the PIN code or other mechanism for accessing the reload, and the payee uses that PIN code or mechanism to load the cash onto the payee's own prepaid card.[7]

The FTC suggested that these payment methods were easily used by telemarketing scammers to defraud consumers, while limiting the ability of consumers to address fraud by, for example, obtaining refunds.

The NPRM also proposed to expand the TSR's existing prohibition on charging consumers advance fees for loss recovery services. The TSR already prohibited collecting an advance fee for services promising to recover losses incurred by consumers in a previous telemarketing transaction. The NPRM proposed to expand the prohibition to cover advanced fees for recovery services relating to losses incurred in any prior transaction, regardless of whether that transaction involved telemarketing.[8]

The Final Rule

As noted above, the Final Rule was published on December 14, 2015, and largely adopted the proposed changes to the TSR that were included in the NPRM, with limited modifications. The following describes the requirements of the Final Rule as well as the standard applied by the FTC in adopting the Final Rule and the FTC's analysis and rationale for the changes to the TSR.

The Standard Applied by the FTC

The Telemarketing Act authorizes the FTC to promulgate rules to prohibit deceptive telemarketing acts or practices and other "abusive" telemarketing acts or practices. In determining whether an act or practice is abusive, the FTC uses the "unfairness" standard under Section 5(n) of the FTC Act. Under that standard, the FTC conducts a three-part analysis regarding a particular act or practice: (1) Is the act or practice likely to cause substantial injury to consumers?; (2) Is the injury reasonably avoidable by consumers?; and (3) is the injury outweighed by countervailing benefits to consumers?[9] Applying this standard, the FTC determined that it was appropriate to prohibit the use of three payment methods discussed below in both inbound and outbound telemarketing calls.

Specifically, the Final Rule amends the TSR to prohibit the use of the following payment methods in payment for goods or services offered or sold (or charitable contributions solicited or sought) through telemarketing:[10]

- Remotely created payment orders ("RCPOs"), defined to include remotely created checks;
- Cash-to-cash money transfers; and
- Cash reload mechanisms

Applying the foregoing three-part test, the FTC first found that the covered payment methods are likely to cause substantial injury to consumers. The FTC cites its law enforcement experience, noting that each of these payment methods are increasingly being used in fraudulent telemarketing schemes. The FTC also cites operational weaknesses and the lack of consumer legal protections, as described further below. Finally, the FTC notes that, despite investigations and enforcement actions, fraudsters continue to use these payment methods because they make it difficult to detect fraud.[11]

Second, the FTC found that consumers could not readily avoid these injuries. The FTC focused on whether consumers can make informed choices. Despite the fact that the FTC recognized the steps taken by many providers of these payment mechanisms to educate consumers, such as posting warnings about the risks associated with using them to make payments to strangers, it nonetheless found that consumers do not understand the nature of these payment methods, the lack of centralized monitoring for certain payment methods to enhance fraud detection, or the differences in laws that apply to different payment methods. Further, the FTC takes the position that, because consumers do not know when a telemarketer is committing fraud, that makes it difficult for the consumer to understand the risks of using these methods to make payments to the telemarketer. Finally, the FTC cites examples of corrupt providers of these payment methods, such as money transfer agents or cash load mechanism providers, who have colluded with fraudsters, or who allegedly have a financial incentive not to uncover fraud and thus lose transaction fees. For all of these reasons, the FTC argues that consumers are not able to make informed choices, but are at the mercy fraudulent telemarketers.[12]

Finally, the FTC found that there were few, if any, countervailing benefits to consumers from allowing telemarketers to use these payment mechanisms. With respect to RCPOs, the FTC states that, because most consumers have debit cards linked to checking accounts, the historical benefits for legitimate telemarketers to use RCPOs are no longer cognizable. For cash-to-cash transfers and cash load mechanisms, the FTC notes that consumers are required to take several burdensome steps after completing a call with a telemarketer (*e.g.*, go to a retail location to initiate the transfer or cash load transaction), and the benefits of these methods, such as being able to send money to family or friends, do not apply in the context of telemarketing. The FTC found that there was little record of legitimate telemarketers using these payment methods, and that the prohibition would enhance the effectiveness of efforts taken by responsible providers of cast-to-cash transfer services and cash load mechanisms to deter and detect abuses. For all of these reasons, the FTC determined that the harm to consumers was not outweighed by any countervailing benefits.[13]

Prohibited Payment Methods

(1) RCPOs[14]

An RCPO is any payment instruction or order drawn on a person's account that is: (1) created by the payee or the payee's agent; and (2) deposited into or cleared through the check clearing system. The Final Rule provides that RCPOs include remotely created checks as defined in Regulation CC.[15] The definition of RCPO originally included in the NPRM had specifically referenced the absence of the payor's signature, but the Final Rule deleted that language to avoid the risk that payees would, for example, apply an image of the payor's signature to evade the Final Rule. Thus, the Final Rule covers items created by the payee or the payee's agent regardless of whether the payor's signature appears on the item.

The FTC explained that it is prohibiting RCPOs because of their operational and regulatory weaknesses. Unlike automated clearing house (ACH) transactions, which are subject to oversight and monitoring by the National Automated Clearing House Association (NACHA), and payment card transactions, which are subject to consumer regulatory protections and network rules and monitoring (including for fraud), the FTC's view is that RCPOs are not subject to centralized and systemic monitoring.

The Supplementary Information accompanying the Final Rule also suggests that, in the FTC's view, RCPOs may not be subject to the consumer protections afforded by Regulation E, which implements the Electronic Fund Transfer Act. However, it should be noted that there has not yet been a definitive ruling by the Consumer Financial Protection Bureau (CFPB) regarding the application of Regulation E to RCPOs that are purely electronic.

(2) Cash-to-Cash Money Transfers[16]

A cash-to-cash money transfer is an electronic transfer of the value of cash received from one person to another person in a different location that is sent by a money transfer provider and received in the form of cash. A money transfer provider is any person or financial institution that provides cash-to-cash money transfers for a person in the normal course of business, whether or not the person holds an account with the money transfer provider.[17]

The FTC's concern with cash-to-cash money transfers is that once the transfer is picked up by the fraudster, there is no recourse available to the consumer to obtain a refund. The Final Rule exempts electronic fund transfers and gift cards that are covered by Regulation E on the theory that Regulation E's liability and error resolution requirements adequately protect consumers. However, the Final Rule does not exempt remittance transfers to persons outside of the United States on the theory that the remittance transfer provisions of Regulation E do not include sufficient consumer protections in connection with fraudulent transactions.

(3) Cash Reload Mechanisms

A cash reload mechanism is a device, authorization code, PIN or other security measure that makes it possible for a person to convert cash to an electronic form that can be used to add funds to a general-use prepaid card (as defined in Regulation E).[18]

The FTC's primary concern with cash reload mechanisms is not the card to which the funds are loaded, but the means by which they are reloaded. For example, the FTC notes that a consumer can purchase a cash reload mechanism, receive a PIN to authorize the load of the funds, and share that PIN over the telephone or Internet to transfer funds onto any existing general use prepaid card within the same network, apply the funds to a digital wallet, or use the funds to pay a utility or other bill. According to the FTC, fraudsters are increasingly asking consumers to pay with a cash reload mechanism by giving the fraudster the consumer's PIN which the fraudster uses to transfer funds to a card or digital wallet held by the fraudster. Once the transfer is completed, the money is gone and cannot be recovered by the consumer.

As with cash-to-cash transfers, the FTC also cites the fact that cash reload mechanisms are not subject to Regulation E (governing electronic fund transfers) or Regulation Z (implementing the Truth in Lending Act, governing credit cards), and therefore lack the error resolution and liability limits provided to consumers under those regulations. This, the FTC determined, results in consumers being exposed to the risk of unrecoverable losses.

The FTC notes, however, that the CFPB has issued a proposed Prepaid Account Rule that would extend the Regulation E protections to certain prepaid accounts, which might cover cash reload mechanisms depending on the content of the CFPB's final regulation. However, the FTC also notes that this likely would only apply to registered cash reload mechanisms (where the consumer provides certain identifying information so that the financial institution can identify the cardholder and verify his or her identity). Unregistered cash reload mechanisms are not likely to be covered. For those reasons, the Final Rule continues to prohibit the use of cash reload mechanisms, although the FTC states that it may revisit the definition of this payment method if warranted by a final Prepaid Account Rule.

Consistent with the FTC's concern with the type of fraud that can be conducted using cash reload mechanisms, the Final Rule does not prohibit the use of a general use prepaid card as a payment method, even one that has been loaded by use of a cash reload mechanism. In addition, several providers of cash reload mechanisms submitted comments noting that when a consumer "swipes" a card to add a cash reload, the card being loaded must be physically present and therefore such reloads do not present the same risk of fraud as other mechanisms. The FTC agreed and for that reason the Final Rule excludes swipe reload processes from the definition of cash reload mechanism.[19]

Inbound Telemarketing

The TSR exempts from certain of its original prohibitions inbound telephone calls initiated by a consumer in response to an advertisement. However, as in the NPRM, the Final Rule does not exempt inbound calls from the new prohibitions. According to the FTC, only one commenter objected to applying the new prohibitions to inbound calls, specifically with respect to RCPOs. However, the FTC was not persuaded because it believes that the risks and operational and regulatory weaknesses associated with RCPOs and the other prohibited payment methods, such as the purported lack of Regulation E protections, applies equally to inbound and outbound calls.[20]

Expansion of Prohibition on Advance Fees

The TSR already prohibited requesting or receiving payment of a fee or consideration for goods or services represented to recover or assist in the return of money or other items of value paid to a person in a previous telemarketing transaction. The Final Rule adopts the NPRM proposal to expand the prohibition on advance fees, prohibiting such fees for services promising to recover a consumer's losses in any prior transaction, not just telemarketing transactions. The FTC reasons that the expansion of the prohibition on advance fees would help prevent fraudsters from avoiding liability under the TSR by focusing on victims of other types of online fraud, and give law enforcement an additional tool to combat online fraud.[21]

Indirect Liability

The TSR prohibits assisting and facilitating sellers or telemarketers engaged in violations of the TSR. The standard applied by the FTC is that a party who has actual knowledge of or consciously avoids knowing about a violation may be liable.[22]

Several commenters raised concerns that, given the nature of the prohibited payment methods, this standard of liability could create unwarranted liability for innocent parties. For example, commenters noted that no single party in the "lifecycle" of a prepaid card may have full visibility into a cash reload transaction, which would make it difficult for a cash reload provider to know whether a particular transaction relates to telemarketing. Similarly, providers of cash-to-cash transfer services may have little ability to know that a transfer relates to a telemarketing transaction.

Despite these comments, the Final Rule makes no changes to the TSR's existing provisions regarding liability. The FTC specifically declined to create safe harbors for cash-to-cash service providers or providers of cash reload mechanisms, finding no reason to afford special treatment to these segments of the industry. The FTC takes the position that such limitations are necessary due to fees that service providers receive when processing improper transactions, and evidence that the incentives created by such fees have led some service to collude with fraudsters in the past. Moreover, the FTC takes the position that the implementation of systems to avoid complicity in unlawful transactions would not create an undue burden. In the FTC's view, many of the leading bona fide service providers have already implemented anti-fraud measures, and commenters failed to provide evidence that service providers would incur excessive new costs as a result of the prohibitions in the NPRM.[23]

Instead, the FTC discusses with favor steps that MoneyGram has taken to improve its fraud prevention and detection efforts in connection with earlier enforcement actions. While the Final Rule does not adopt or require these measures, the FTC's discussion suggests that adopting similar measures will help avoid liability for assisting or facilitating violations of the TSR. The measures include: (1) providing consumer warnings; (2) providing a mechanism for a consumer to reverse a money transfer if the funds have not been picked up and the consumer alleges that the transfer was induced by fraud; and (3) establishing, implementing, and maintaining a comprehensive anti-fraud program reasonably designed to detect and prevent fraud-induced money transfers and money transfer agents who might be complicit in fraud.[24] In light of the FTC's commentary, other money transfer service providers and providers of the other payment methods that are prohibited in connection with telemarketing might consider implementing similar measures.

Analysis and Impact

Before discussing the likely impact of the amendments to the TSR, it is worth noting that, in promulgating the Final Rule, the FTC largely rejected comments from the financial services industry. In several cases, the FTC rejected the comments on the grounds that the commenter did not provide examples or data to support its claims.[25] This highlights the importance of hard evidence in making a case during the FTC's rulemaking process. The FTC also relied on the fact that commenters did not cite any use of the banned payment methods in lawful and legitimate telemarketing activities.[26] In other cases, the FTC simply disagreed with comments regarding the potential impact of the prohibitions, the legitimate uses of these payment methods, and existing protections for consumers. Similarly, although the American Bankers Association (ABA) argued that the proposed rule would be a direct and impermissible regulation of banks that exceeds the FTC's authority, the FTC rejected the ABA's position.[27] In short, the FTC generally failed to accept criticisms offered by the financial services industry in response to the NPRM, including concerns raised about the likely impact of the proposed changes.

The FTC understandably is concerned with protecting consumers from fraudulent activities, and indeed its mandate is to do just that. The question is, however, whether the changes to the TSR will effectively advance the FTC's goal and at what cost? Arguably, the FTC overestimates the impact that the ban on three payment methods will have on reducing fraud in the long run, while underestimating the adverse effect the ban will have on legitimate payment service providers in non-fraudulent transactions and consumers who seek to use those services.

A fraudster is unlikely to be dissuaded from using a payment method simply because its use is banned by the FTC. There is little reason to believe that an individual who already intends to defraud a consumer will think twice simply because the payment method it intends to use to commit the fraud is also prohibited.[28] If fraudsters are unlikely to be deterred, does the Final Rule make it any more likely that otherwise unsuspecting consumers will recognize potential telemarketing fraud due to the linkage to a particular payment mechanism? The assumption that they will seems a leap of faith, and makes it all the more important that the Final Rule not have collateral adverse impacts.

If the direct impact on fraudsters and consumers from the Final Rule is limited, the rationale that actually seems to drive the Final Rule is the idea that payment intermediaries faced with this new prohibition will act systemically to prevent telemarketers from accessing the designated payment systems. Indeed, the FTC expends significant efforts discounting any potentially adverse effects on "legitimate" telemarketing activities due to the Final Rule, highlighting that no commenter had identified examples of the use of the three banned payment methods in any legitimate telemarketing transaction. This analysis is misguided, however, in that the cost of implementing the Final Rule will be felt not only in lost opportunities for legitimate telemarketing activities, but also much more broadly as payment providers take steps to reduce the new compliance risks created by the Final Rule.

The inevitable drive to "de-risk" through new compliance regimes will be aggravated by the FTC's refusal to change its liability standard for service providers in the context of the three payment methods that the TSR now bans. The limited ability of such service providers to detect potential violations, coupled with other de-risking activities arising out of experiences with "Operation Chokepoint" and other regulatory enforcement initiatives, will incentivize service providers to limit the availability of these payment methods even for legitimate uses. For example, banks may be unable to distinguish between RCPOs and traditional checks, and may not be able to effectively determine whether an RCPO relates to a telemarketing transaction. Similarly, providers of cash-to-cash transfer services and cash reload mechanisms have little ability to know that a transaction involves telemarketing. In the face of limits on their ability effectively to detect and prevent the use of the banned payment methods in telemarketing transactions, providers are likely to be overbroad when taking steps to implement the restrictions in the Final Rule.

While payments providers may be able to reduce their risk through measures such as making disclosures to consumers, implementing technological protections, and enhancing due diligence of their payments customers, recent enforcement history will make them leery of overreliance on the "conscious avoidance" standard. As a result, many such providers may begin to more strictly limit the use of these payment methods, meaning that legitimate uses, as well as illegitimate ones, would be curtailed. This obviously would have an adverse affect not only on the service providers, but also on consumers who otherwise find these payment methods useful, but may no longer have access to them. In short, while well-intentioned, the Final Rule will provide implementation challenges for payments providers, and risks unintentionally restricting legitimate payment activities.

ENDNOTES:

[1]80 Fed. Reg. 77,520 (Dec. 14, 2015). Certain requirements of the Final Rule will be effective on February 12, 2016, but the new ban on accepting certain payment methods will be effective on June 13, 2016. *See id*.

[2]78 Fed. Reg. 41,200 (July 9, 2013).

[3]15 U.S.C. §§ 6101-6108.

[4] *See* 15 U.S.C. § 6105(b); 15 U.S.C. § 45(a)(2).

[5]80 Fed. Reg. 77,520 (Dec. 14, 2015).

[6] *See* 16 C.F.R. §§ 310.3, 310.4.

[7] *See* 80 Fed. Reg. 77,521-24.

[8] *See* 80 Fed. Reg. 77,524.

[9]15 U.S.C. § 45(n).

[10] *See* 80 Fed. Reg. 77,559 (to be codified at 16 C.F.R. §§ 310.4(a) (9) and (10)).

[11] *See* 80 Fed. Reg. 77,528-35, and 77,547-49.

[12] *See* 80 Fed. Reg. 77,535-37, and 77,549-50.

[13] *See* 80 Fed. Reg. 77,537-41, and 77,550-53.

[14] *See* 80 Fed. Reg. 77,521-23 and 77,525-42 for the FTC's discussion of the NPRM and Final Rule relating to RCPOs, including the comments received in response to the NPRM and the FTC's analysis under its three-part unfairness test.

[15] *See* 80 Fed. Reg. 77,558 (definition of "Remotely created payment order," to be codified at 16 C.F.R. § 310.2(cc)). Regulation CC is issued by the Board of Governors of the Federal Reserve System and governs the availability of funds and the collection of checks. See 12 C.F.R. pt. 229. Regulation CC defines a remotely created check as "a check that is not created by the paying bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn." 12 C.F.R. § 229.2(fff).

[16] *See* 80 Fed. Reg. 77,523-24 and 77,542-54 for the FTC's discussion of the NPRM and Final Rule relating to cash-to-cash money transfers and cash reload mechanisms, including the comments received in response to the NPRM and the FTC's analysis under its three-part unfairness test.

[17] *See* 80 Fed. Reg. 77,558 (definition of "Cash-to-cash money transfer," to be codified at 16 C.F.R. § 310.2(f)).

[18] *See* 80 Fed. Reg. 77,558 (definition of "Cash reload mechanism," to be codified at 16 C.F.R. § 310.2(g)).

[19] *See* 80 Fed. Reg. 77,523-24, and 77,553-54; *see also id*. at 77,558 (definition of "Cash reload mechanism," to be codified at 16 C.F.R. § 310.2(g)).

[20] *See* 80 Fed. Reg. 77,542.

[21] *See* 80 Fed. Reg. 77,554; see also id. at 77,559 (to be codified at 16 C.F.R. § 310.4(a)(3)).

[22] *See* 16 C.F.R. § 310.3(b); see also 80 Fed. Reg. 77,552.

[23] *See* 80 Fed. Reg. 77,550-53.

[24] *See* 80 Fed. Reg. 77,547-48.

[25] *See, e.g.*, 80 Fed. Reg. 77,527 (stating that a commenter who asserted that novel payment methods are extremely important and that the amended TSR would increase the cost of collecting payments and charitable donations did not provide support for its claims, and that commenters from the financial services industry did not provide specific support or evidence for their claims).

[26] *See, e.g.*, 80 Fed. Reg. 77,527, 77,545 and 77,546.

[27] *See* 80 Fed. Reg. 77,527.

[28]This point was made by some commenters as well. *See, e.g.*, 80 Fed. Reg. 77,527.