

## *FTC Moves to Regulate the Use of Certain Payment Methods in Telemarketing Sales Rule*

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On May 21, 2013, the Federal Trade Commission (“FTC”) issued a Notice of Proposed Rulemaking (“NPR”) to amend the Telemarketing Sales Rule (“TSR”)<sup>1</sup> to ban sellers and telemarketers from using certain payment instruments as payment for telemarketing transactions.<sup>2</sup> Payment instruments covered by the NPR include remotely-created checks and payment orders, cash-to-cash money transfers, and cash reload mechanisms.

The NPR also proposes expanding the scope of the ban on the payment of advance fees paid for so-called “recovery services.”<sup>3</sup> Currently, the ban on advance fees for “recovery services” is limited to the recovery of losses arising from prior telemarketing transactions. The NPR would expand the advance fee ban to include the recovery of losses in any prior transaction.

The NPR follows recent enforcement actions by the FTC addressing violations of federal statutes regulating the conduct of consumer financial transactions. These actions and the NPR serve as notice to financial services providers beyond the reach of Federal Banking regulators and the Consumer Financial Protection Bureau (“CFPB”) regarding the expanding approach by all regulators with respect to the application and enforcement of consumer financial protection laws.

### **Proposed Amendments to the TSR**

In proposing to ban the use of remotely-created checks and payment orders, cash-to-cash money transfers, and cash reload mechanisms for telemarketing transactions, the FTC notes that, unlike credit and debit cards, these payment methods lack: (1) federal consumer protection regulation, and (2) centralized monitoring and control, which makes them extremely susceptible to fraudulent activity.<sup>4</sup> While credit card transactions are subject to the Truth in Lending Act (“TILA”)<sup>5</sup> and Regulation Z,<sup>6</sup> and debit card transactions are subject to the Electronic Fund Transfer Act (“EFTA”)<sup>7</sup> and Regulation E<sup>8</sup> consumers using remotely-created checks and payment orders lack protections such as a prescribed error resolution process and statutory limits on liability. These “novel payment methods,” which are governed by state law (Uniformed Commercial Code), also lack the dispute resolution procedures available to credit card and debit card users. This greatly increases the cost to a consumer in contesting a fraudulent payment.

The NPR also highlights that these payment methods are more susceptible to fraudulent schemes because they are routed through the check clearing system, which lacks the centralized fraud monitoring that occurs with payment networks for debit and credit card transactions. In addition, cash-to-cash transfers and cash reload mechanisms are not sufficiently regulated under current federal and state money transmitter regulations, which focus on regulating providers, not protecting consumers, and have become more prevalent in fraudulent schemes uncovered by law enforcement.<sup>9</sup> Accordingly, the NPR would treat the use of these “novel payment methods” for telemarketing purposes as an “abusive telemarketing act or practice” in violation of Section 5 of the Federal Trade Commission Act.<sup>10</sup>

In amending the TSR to prohibit telemarketers and sellers of recovery services from accepting advance fees from consumers who have lost money in any prior transaction (*i.e.* not just a prior telemarketing transaction), the NPR notes that the internet has become a significant source of fraud against consumers.<sup>11</sup> Telemarketers running fraudulent recovery schemes have been able to avoid the advance recovery fee prohibition by targeting victims of online scams and steering clear of offering recovery services for telemarketing transactions.<sup>12</sup> The NPR would close this technological loophole.

The NPR also proposes amending the TSR to: (1) specify that the recording of a consumer’s express verifiable authorization must include a description of the goods or services being purchased; (2) state expressly that a seller or telemarketer bears the burden of demonstrating that the seller has an existing business relationship with, or has obtained an express written agreement from, a person whose number is listed on the do-not-call registry; (3) clarify that the business-to-business exemption extends only to calls to induce a sale to or contribution from a business entity, and not to calls to induce sales to or contributions from individuals employed by the business; (4) emphasize that the prohibition against sellers sharing the cost of do-not-call registry fees, which are nontransferable, is absolute; and (5) illustrate the types of impermissible burdens that deny or interfere with a consumer’s right to be placed on a seller’s or telemarketer’s entity-specific do-not-call list.<sup>13</sup>

### **Additional FTC Actions Enforcing Consumer Financial Protection Laws**

The proposed changes to the TSR follow an increased focus by the FTC on consumer financial fraud. Although much of the financial services industry’s recent focus with respect to consumer financial protection issues has focused on the CFPB, the FTC also has jurisdiction over unfair, deceptive, or fraudulent practices in a variety of industries, including financial services.<sup>14</sup> In addition to enforcing certain consumer protection laws, the Dodd-Frank Act Wall Street Reform and Consumer Protection Act (“DFA”) provided the FTC with authority to enforce CFPB rules applicable to non-bank entities within the FTC’s jurisdiction. The proposed rule is significant to industry participants not only because of its proposed restrictions, but also because the FTC is taking a proactive step toward increased regulation and oversight of consumer financial services.

In 2012, the FTC initiated enforcement actions involving a number of financial consumer protection laws, including TILA and Regulation Z, the Consumer Leasing Act (“CLA”)<sup>15</sup> and Regulation M,<sup>16</sup> the EFTA and Regulation E, and the Equal Credit Opportunity Act (“ECOA”)<sup>17</sup> and Regulation B.<sup>18</sup> While agency actions included non-mortgage credit advertising, mortgage loan advertisements, forensic audit scams, and electronic fund transfers, the majority of the FTC’s actions related to TILA and the EFTA. These included the following:

- **Automobile Lending.** The FTC filed complaints and settled charges with five automobile dealers for making false and misleading representations, and for violations of TILA and

Regulation Z and the FTC Act. The dealers allegedly made deceptive claims in advertisements that they would pay off the full amount the consumer owed on traded-in vehicles, when in reality the dealers rolled the loan balance on the trade-in vehicle into the consumer's new vehicle loan, or required the consumer to pay it out of pocket. The final orders in these cases prohibit the auto dealers from making these types of deceptive claims and require them to comply with TILA and Regulation Z.

- **Payday Lending.** The FTC filed a complaint against a payday lender and related entities alleging that they charged consumers undisclosed and inflated fees and illegal collection practices, in violation of TILA and Regulation Z.
- **Automobile Loan Modification.** The FTC filed charges against two auto loan modification operations for charging hundreds of dollars in up-front fees, based on false promises they could reduce consumers' monthly car loan payments and help avoid repossession of their vehicles. One of the cases was settled. These represent the FTC's first cases against companies offering auto loan modifications.
- **Mortgage Lending.** In 2011, the FTC issued a rule banning deceptive claims about consumer mortgages in advertising or other types of commercial communications (the "MAP-Ad Rule"). In 2012, the FTC, in coordination with the CFPB, issued letters to 20 companies warning that their advertisements may be deceptive and in violation of the MAP-Ad Rule and the FTC Act. The CFPB also issued warning letters to approximately a dozen other companies. Both agencies have opened enforcement investigations of other advertisers that may have violated federal laws including TILA and Regulation Z.
- **Electronic Fund Transfer Act Enforcement Actions.** The FTC has participated in five "negative option" plan cases alleging violations of EFTA and Regulation E. Under such plans, a consumer agrees to receive various goods or services from a company for a trial period at no charge or at a reduced price. The company also obtains the consumer's credit or debit card number, and if the consumer does not cancel before the end of the trial period, the shipments of goods or provision of services continue, and the consumer incurs recurring charges. The FTC obtained a \$9.6 million judgment in one case,<sup>19</sup> obtained settlements in two other cases, and continues to litigate the remaining two cases. The FTC also filed new cases involving electronic fund transfers in the payday lending and debt relief areas.
- **Enforcement Authority for Payment Cards.** The DFA also assigned the FTC new enforcement authority for payment cards.<sup>20</sup> The FTC has responsibility for enforcing the new requirements and regulations for payment card networks and certain other non-bank entities. Pursuant to this authority, on December 24, 2012, the FTC issued its first required report to Congress on its law enforcement, outreach, and other activities to implement these new requirements.<sup>21</sup>

Moving forward, it is clear that nonbank entities in the financial services industry must be vigilant regarding compliance with these various consumer protection laws within the FTC's (and in some cases, the CFPB's joint) jurisdiction and authority.

### **Implications for Financial Service Institutions**

With issuance of the NPR and several other recent enforcement actions, it appears that the FTC is taking a significantly more activist role in regulating the activities of providers of consumer financial products and services that are subject to its jurisdiction. While it remains to be seen how aggressively

the FTC may pursue and enforce consumer financial protection laws, it is clear that, in combination with the CFPB, nonbank financial services firms are being subject to a more comprehensive and rigorous set of standards with respect to the application of consumer financial protection laws. This has implications at both the federal and state level, particularly given the extent to which state regulators are overseeing and enforcing state consumer protection laws, both individually and, we expect, collectively with the CFPB and FTC (as well as other federal regulators, including the federal banking agencies). It seems clear that all of these agencies will continue to focus and refine their approach on enforcement related to actual and potential violations of statutes and regulations under their supervision for consumer-facing financial transactions.

Given the continued development of laws, policy and federal and state activism with respect to consumer financial protection laws, nonbank financial firms should carefully review their customer-facing activities involving financial transactions to assess the potential compliance, regulatory and enforcement risks to which they may be exposed. In particular, nonbank financial firms should carefully study prior enforcement actions by the FTC, CFPB, and state regulators (as well as those of federal and state banking regulators) involving unfair, deceptive, or fraudulent acts or practices with respect to the offer or sale of consumer financial products and services. Certainly, an important step in this process will be for nonbank financial firms to consider the type of consumer financial compliance review that has typically been conducted, until now, by banks and their service providers.

In addition, firms specifically impacted by provisions of the NPR should review the attached questions, which are set forth in the NPR, and consider whether to provide a letter to the FTC that is responsive to specific issues or concerns that warrant comment.

*Paul Hastings lawyers are actively assisting clients with a variety of matters involving the application of federal and state consumer financial protection laws, as well as issues related to ensuring that the offer and sale of consumer financial products and services do not pose potential risks related to unfair, deceptive, or fraudulent acts or practices for a financial services firm. Our lawyers are available to address any questions or issues regarding these potential risks, as well as to assist you regarding establishing and maintaining your consumer financial protection compliance programs.*

**Appendix: Questions for Comment**General Questions for Comment

1. *What would be the impact (including any benefits and costs), if any, of the proposed amendments on consumers?*
2. *What would be the impact (including any benefits and costs), if any, of the proposed amendments on individual firms (including small businesses) that must comply with them?*
3. *What would be the impact (including any benefits and costs), if any, on industry, including those who may be affected by the proposed amendments but not obligated to comply with the Rule?*
4. *What changes, if any, should be made to the proposed amendments to minimize any costs to consumers or to industry and individual firms (including small businesses) that must comply with the Rule?*
5. *How would each change suggested in response to Question 4 affect the benefits that might be provided by the proposed amendment to consumers or to industry and individual firms (including small businesses) that must comply with the Rule?*
6. *How would the proposed amendments impact small businesses with respect to costs, profitability, competitiveness, and employment? What other burdens, if any, would the proposed amendments impose on small businesses, and in what ways could the proposed amendments be modified to reduce any such costs or burdens?*
7. *How many small businesses would be affected by each of the proposed amendments?*
8. *With respect to each of the proposed amendments, are there any potentially duplicative, overlapping, or conflicting federal statutes, rules, or policies that are currently in effect?*

Questions on Specific Issues

Novel Payment Methods: Remotely Created Checks, Remotely Created Payment Orders, Cash-to-Cash Money Transfers, and Cash Reload Mechanisms

9. *Does the proposed definition of "remotely created check" adequately, precisely, and correctly describe this payment alternative? If not, please provide alternative language or suggestions as to how the Commission could improve the definition.*
10. *Does the proposed definition of "remotely created payment order" adequately, precisely, and correctly describe this payment mechanism? If not, please provide alternative language or suggestions as to how the Commission could improve the definition.*
11. *Does the proposed definition of "cash-to-cash money transfer" adequately, precisely, and correctly describe this payment mechanism? If not, please provide alternative language or suggestions as to how the Commission could improve the definition.*
12. *Does the proposed definition of "cash reload mechanism" adequately, precisely, and correctly describe this payment mechanism? If not, please provide alternative language or suggestions as to how the Commission could improve the definition.*
13. *Should the Commission amend the TSR to prohibit the use in telemarketing of remotely created checks, remotely created payment orders, cash-to-cash money transfers, and cash reload mechanisms as payment options?*
14. *What, if any, systematic fraud monitoring exists for remotely created checks, remotely created payment orders, cash-to-cash money transfers, and cash reload mechanisms?*

15. *What, if any, dispute resolution rights for consumers are provided in connection with remotely created checks, remotely created payment orders, cash-to-cash money transfers, and cash reload mechanisms?*
16. *Are there widely available payment alternatives to remotely created checks, remotely created payment orders, cash-to-cash money transfers, and cash reload mechanisms sufficient for use in telemarketing by consumers who lack access to credit or traditional debit cards? If not, please describe the reasons why these novel payment methods are necessary and the types of telemarketing transactions for which these novel payment methods are necessary, including the types of products or services involved, whether the telemarketing calls are inbound or outbound, etc.*
17. *What, if any, adverse effect would a prohibition on the use of remotely created checks and remotely created payment orders in telemarketing have on legitimate electronic bill payment transactions?*
18. *Do banks have any feasible way of distinguishing among traditional checks, remotely created checks, images of remotely created checks and remotely created payment orders flowing through the check clearing system?*
19. *Is it feasible to obtain systematic, centralized monitoring of the volume, use, or return rates of remotely created checks and remotely created payment orders flowing through the check clearing system?*
20. *Do payment processors and depository banks typically receive additional fees when processing payments and returns for merchants with high return rates? Do they incur additional costs in dealing with merchants with high return rates?*  
*Please describe the nature and amount of any such fees and costs, including how the additional fees charged compare to the increased costs incurred by the payment processors and banks.*
21. *Do consumers generally understand the differences among different payment options for purchases with regard to their dispute resolution rights and ability to recover payments procured by fraud?*
22. *Are there legitimate uses for cash-to-cash money transfers and cash reload mechanisms in telemarketing? If so, please describe the reasons why such transfers are necessary and the types of telemarketing transactions for which such transfers are necessary, including the types of products involved, whether the telemarketing calls are inbound or outbound, and whether the need is limited to certain groups of consumers – e.g., those who do not have bank accounts. In addition, please provide information as to why these transactions could not be conducted using alternative payment mechanisms such as electronic fund transfers or debit or credit cards, including what additional costs, if any, would result from using such payment alternatives.*
23. *What specific costs and burdens would the proposed prohibition on the use of remotely created checks, remotely created payment orders, cash-to-cash money transfers, and cash reload mechanisms in telemarketing impose on industry and individual firms (including small businesses) that would be required to comply with the prohibition, or on consumers?*
24. *Is the harm caused by remotely created checks, remotely created payment orders, cash-to-cash money transfers, and cash reload mechanisms in telemarketing outweighed by countervailing benefits to consumers or competition? If so, please identify and quantify the countervailing benefits.*

25. *Are there other payment mechanisms used in telemarketing that cause or are likely to cause unavoidable consumer harm without countervailing benefits to consumers or competition that the Commission should consider prohibiting or restricting?*

#### Advance Fees for Recovery Services

26. *Is there any material difference between telemarketing sales and Internet sales that would require the use of advance fees for recovery services aimed at victims of Internet fraud?*
27. *What, if any, specific costs and burdens would the proposed expansion of the advance fee ban on recovery services impose on industry and individual firms (including small businesses)?*
28. *Please describe the types of businesses that seek advance fees for recovery services, and whether these businesses require significant capital or labor outlays prior to providing the services.*

#### General Media Exemption

29. *How many sellers and how many telemarketers that accept payment by remotely created checks, remotely created payment orders, cash-to-cash money transfers or cash reload mechanisms solicit calls from consumers by means of general media advertisements?*
30. *What specific costs or burdens, if any, would be imposed by the proposed exclusion from the general media exemption for calls to sellers or telemarketers that accept payment?*
31. *Does the TSR's general media exemption have so many exclusions that the Commission should consider eliminating the exemption entirely?*

#### Direct Mail Exemption

32. *How many sellers and how many telemarketers that accept payment by remotely created checks, remotely created payment orders, cash-to-cash money transfers, or cash reload mechanisms solicit calls from consumers by means of direct mail offers?*
33. *What specific costs or burdens, if any, would the proposed amendment to the direct mail exemption impose on industry, on individual firms (including small businesses) that would be required to comply with the prohibition, or on consumers?*
34. *Should the proposed changes to the direct mail exemption be limited to certain types of industries (or goods or services) that are susceptible to abuse?*

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*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

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<sup>1</sup> 16 C.F.R. § 310.

<sup>2</sup> See FTC, Telemarketing Sales Rule, Notice of Proposed Rulemaking and Request for Public Comment (May 21, 2013) (“NPR”), online at <http://www.ftc.gov/os/2013/05/130521telemarketingsalesrulefrn.pdf>.

<sup>3</sup> Id.

<sup>4</sup> Id. at 9–10.

<sup>5</sup> 15 U.S.C. § 1601 et seq.

<sup>6</sup> 12 C.F.R. Part 1026; 12 C.F.R. Part 226.

<sup>7</sup> 15 U.S.C. § 1693 et seq.

<sup>8</sup> 12 C.F.R. Part 1005; 12 C.F.R. Part 205.

<sup>9</sup> NPR at 45–47.

<sup>10</sup> Id. at 39 & 57.

<sup>11</sup> Id. at 62.

<sup>12</sup> Id.

<sup>13</sup> NPR at 3.

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- <sup>14</sup> Pursuant to the DFA, the FTC retains its authority to enforce TILA, CLA, EFTA, and ECOA, among other rules.
- <sup>15</sup> 15 U.S.C. § 1667 et seq.
- <sup>16</sup> 12 C.F.R. § 1013.
- <sup>17</sup> 15 U.S.C. § 1691 et seq.
- <sup>18</sup> 12 C.F.R. § 1002; 12 C.F.R. § 202.
- <sup>19</sup> FTC v. Ultralife Fitness Inc., No. CV08-07655 (C.D. Cal. June 6, 2012).
- <sup>20</sup> See Dodd-Frank Act § 1075.
- <sup>21</sup> See Federal Trade Commission Report on Activities Related to Section 1075 of the Dodd-Frank Act (Dec. 24, 2012), online at <http://www.ftc.gov/opa/2012/12/DoddFrankReport.pdf>.