

Donald J. Mosher
Jessica Sklute
Schulte Roth & Zabel LLP

Bill Payments, Regulation and Compliance

Agenda

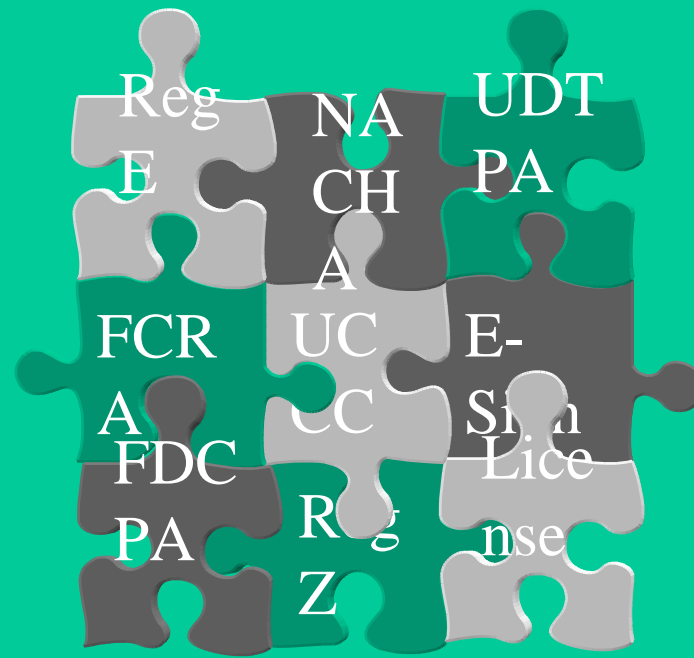
- Issues Affecting Bill Payments
- Information Privacy and Information Safeguarding
- Questions

TRENDS

- Substantial Channel Competition.
 - Increased Growth in ACH/EFT Networks; Accounts Receivable Conversions.
- 52% of consumers use automatic payment to pay at least one bill per month, and 39% use online bill payment
- Checks now account for only 49% of consumers' monthly bill payments – down from 72% in 2001, and 60% in 2003.
 - American Bankers Association 2005/2006 Study of Consumer Payment Preferences.
- Automatic payments surpass checks for first time as bill-paying method; recurring payments by debit cards show largest growth.
 - 2005 MasterCard Recurring Payments Awareness, Behavior & Attitude Study.

Overview

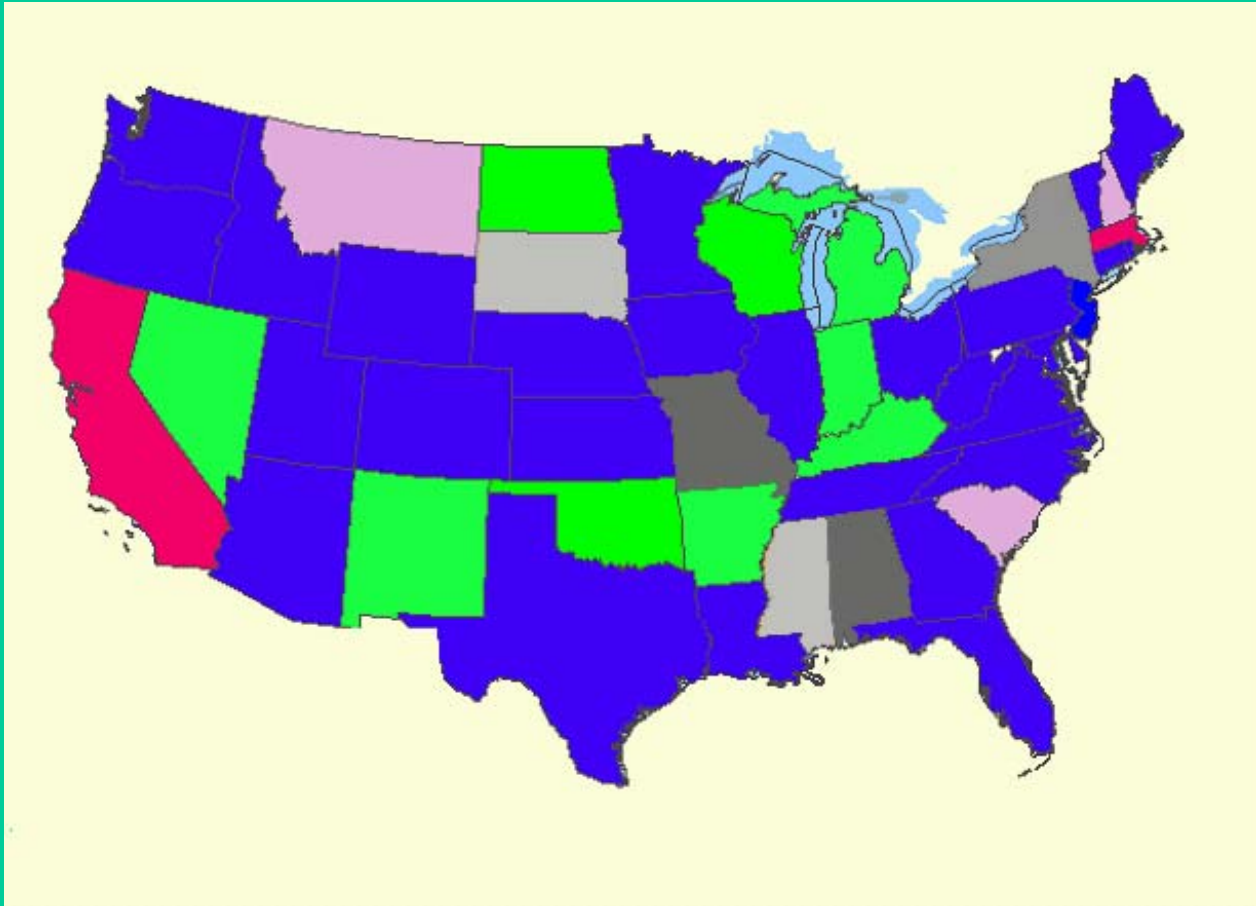
- Regulation and Compliance Environment is Technical and Evolving
- Prevalent Theme - Consumer Protection



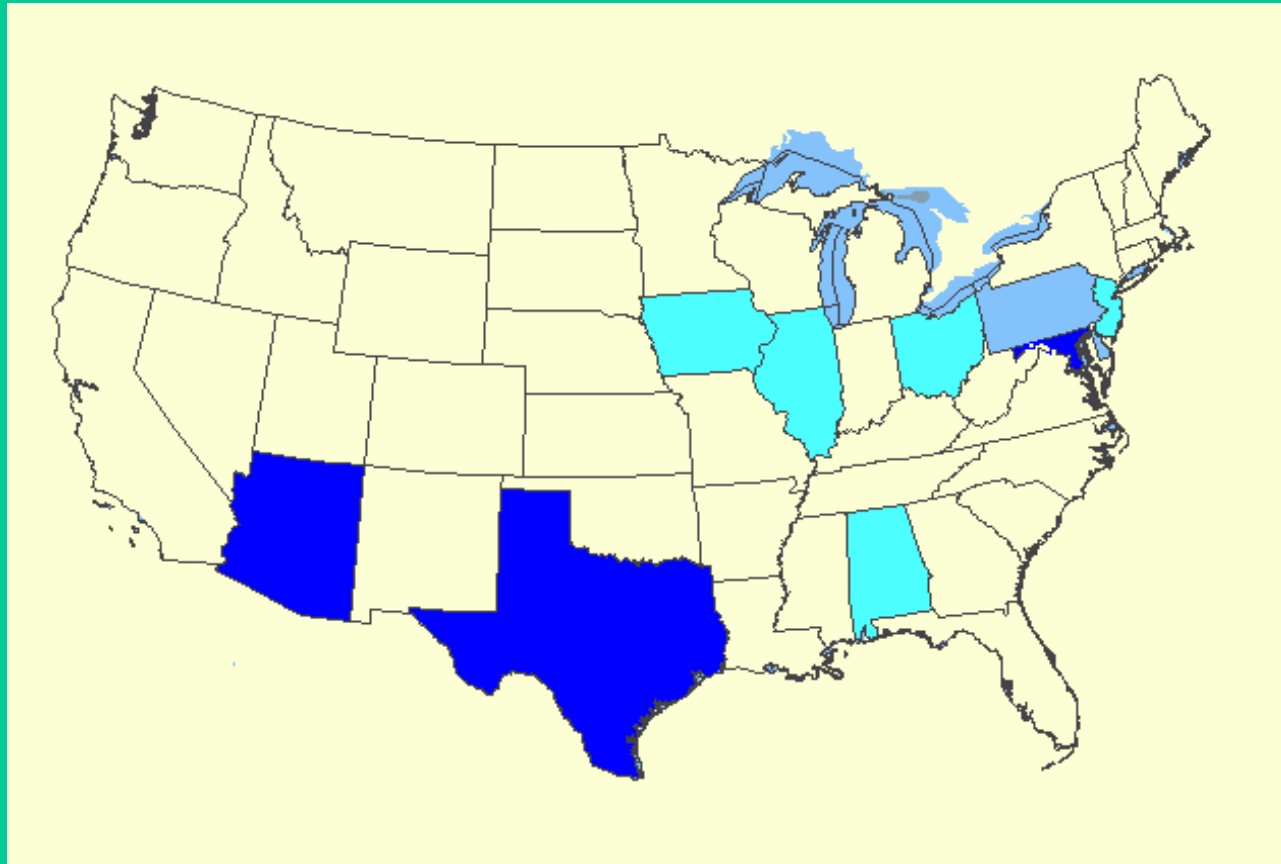
Issues List

- Applicable Law
- Money Transmitter Laws
- Agent Oversight
- Regulation E and the NACHA Rules
- E-Sign and Contract Creation
- State Consumer Protection Laws
- Debt Collection Laws
- Fraud Risk, Credit Risk and FCRA
- Intellectual Property
- AML Compliance Procedures and OFAC Compliance
- Credit Card/Debit Card Association Rule Compliance
- Information Privacy and Information Safeguarding

Money Transmission (Map # 1)



Money Transmission (Map # 2)



Agent Oversight

- Adequate policies, procedures and controls to cover activities of agents
- Diligence in Selection of Agents
- Written Agreement
 - Frequent Transmission of Data and Payments
 - Recordkeeping and Compliance Obligations
 - Some states require certain prescribed provisions
 - Effective termination provisions for non-compliant agents
- Training and Monitoring

Regulation E and NACHA Rules

- Federal Reserve Board, Regulation E, promulgated under the Electronic Fund Transfers Act
 - establishes the basic rights, liabilities, and responsibilities of consumers who use electronic fund transfer services and financial institutions and certain other persons that offer these services.
- NACHA Rules
 - rules and regulations issued by the National Automated Clearing House Association that govern the ACH Network
- Applies to electronic debits to a consumer account.

Internet (ACH)

- Authorization
 - Writing
 - Readable on screen
 - Prompted to Print and Save
 - Make hard copy available
 - Readily identifiable as ACH debit authorization
 - Clearly and conspicuously state terms
 - If for recurring payments, provide the consumer with the a method to revoke the authorization
 - signed or “similarly authenticated”

Internet – Similarly Authenticated

- Similarly authenticate authorization using method compliant with E-Sign that evidences consumer's:
 - Identity
 - Assent to the authorization
- Same process for recurring or single-entry
 - Satisfies “writing signed or similarly authenticated” requirement imposed on recurring debits by Regulation E
- Same process for existing relationship or no-relationship

Telephone (ACH)

- Authorization
 - Writing
 - signed or similarly authenticated
 - E-Sign
 - Identity
 - Assent
 - Oral (non-recurring only)
 - TEL-Entry

Telephone – Similarly Authenticate

- Method compliant with E-Sign that evidences consumer's:
 - Identity
 - Assent to the authorization
- NACHA Guidelines: “Key enter or verbally express the 4-digit (min) code [which must be on the written authorization that is in the consumer’s possession when this telephone conversation occurs.]”
- Same process for recurring or single-entry debits
 - Satisfies “writing signed or similarly authenticated” requirement imposed on recurring debits by Regulation E
 - NACHA guidelines suggest that this process is not available for single-entry debits if you make a call to a consumer with whom you have no relationship

Telephone – Oral Authorization

- TEL-entry
 - One-time (non-recurring) ACH debits
 - No existing relationship, consumer must initiate call
 - Recorded OR written confirm provided
 - 6 pieces of information required on the call (and, if provided, on the written confirm)
 - Date on or after account will be debited
 - Amount
 - Consumer's name
 - Customer service number
 - Date of authorization
 - That the authorization will be used to originate an ACH debit to consumer's account

Internet and Telephone Bill Payments - Disclosure

- NACHA
 - Authorization components
- FCRA
 - Identity verification tool vs. consumer report
- State Consumer Protection Laws
 - Clear and conspicuous
 - Not false or misleading
- Regulation E

Regulation E – “Access Device”

- Includes:
 - Debit Cards, PINs, telephone transfer and telephone bill payment codes
 - Other means used by consumers to initiate EFTs to or from consumer account
- ID info in response to ID verification questions not likely to be access device

Regulation E – Disclosures

- Consumer rights and liabilities
 - Unauthorized
 - Incorrect EFT
 - Consumer generally has 60 days from statement date (NACHA period runs from settlement date)
- Error resolution procedures
 - Time limits
 - Investigation
 - provisional re-credit
 - report results to consumer
- No periodic statement required if certain provisions met

Regulation E – Notice of Transfers in Varying Amount

- 10 days written notice before date of transfer that will vary in amount from:
 - previous transfer; or
 - pre-authorized amount
- Payee or Financial Institution may give consumer option of receiving notice only when:
 - Transfer falls outside a specified range; or
 - Only when a transfer differs from the most recent transfer by more than an agreed-upon amount

Recurring Credit Card Payments

- Regulation E does not apply to recurring credit card payments, but does apply to recurring debit card payments.
 - Procedures reasonably adapted to determine whether a debit card is being used.
 - Regulation E Staff Commentary 10(b)(7). If the payee is unable to determine, at the time of the authorization, whether a credit or debit card number is involved, and later finds that the card used is a debit card, the payee must obtain a written and signed or (where appropriate) a similarly authenticated authorization as soon as reasonably possible, or cease debiting the consumer's account.
- Last year (9/17/04), the Federal Reserve proposed an amendment to the commentary to clarify that asking whether card is credit or debit is a reasonable procedure.

General Risks and Concerns

- Intellectual Property
- Debt Collector Laws
- BSA/OFAC
- Card Association Rules
 - Cash Advance
 - Consumer choice
 - Surcharges
- Fees and Re-presentments
- Information Privacy and Information Safeguarding

“[Client] has notified us of a security breach in [city] involving client/employee files. Details are sketchy, but it looks like [the service provider] that handles [Client's] file storage needs had one of its truck doors blow open on a city street, scattering sensitive files and documents all over town. We have little information, but it appears the files included passport numbers, client account statements, and the like. They've asked for our advice on the security breach notification legislative and regulatory obligations that may be triggered by the problem, on an emergency basis.”

Privacy/Information Security

Federal Gramm-Leach-Bliley Act ("GLBA")

- Applies to businesses (financial institutions) "significantly engaged" in providing financial products or services to consumers and financial companies that receive information from other financial institutions about their consumers
- Two components: (1) Information Privacy (2) Information Safeguarding
- Privacy of Consumer Financial Information Rules/Standards for Safeguarding Customer Information

State Law

Privacy/Information Security cont

Nature of Relationship with Consumer/Delivery Channel

- Agreement with Biller (acting on behalf of biller or consumer)
- Consumer Relationship
- Customer Relationship – certain ongoing consumer relationships

Factors to Consider: Initial and Annual Notice Requirement (and procedures for delivery); Opt-Out Requirement/Notices (procedures to implement and monitor); Re-Use and Re-disclosure; applicability of third party's privacy policy; contractual obligations with third parties

-these may be determined by (1) nature of relationship with consumer; (2) your intended further use of information

Information Safeguarding

FTC Safeguards Rule

- Requires written policy establishing program for administrative, technical and physical safeguards for securing customer information
- Requires designation of information security officer
- Risk based approach
- Obligations will vary based on delivery channel and channels for receipt and storage of information (e.g., electronic receipt/storage of information or receipt/storage of hardcopies on or off premises)
- Program should identify reasonably foreseeable risks to security of information and records about consumers and assess the effectiveness of existing safeguards for controlling these risks
- Special Concerns for Certain Money Transmitters: compliance by authorized agents

Enforcement

Recent Enforcement Actions

- Section 5 of the Federal Trade Commission Act (Unfair and Deceptive Practices)
 - Eli Lilly, Microsoft, Guess, Tower Records, Petco, BJ's Wholesale
- Gramm-Leach-Bliley Safeguards Rule
 - Sunbelt Lending Services

Pending Claims/Legal Theories

- Unauthorized Access/System Breaches

What this all means for Money Transmitters

New Developments/Active Regulatory Landscape

- State Laws and Security Breach Notification (New York State, California, Other States)
- Federal -Pending Legislation

Best Practices

Develop and Implement an Information Privacy and Security Policy

- Procedures should be appropriate to your size and complexity, the nature and scope of your activities, and the sensitivity of the information that you possess
- Responsible individual/privacy officer
- Periodic review
- Board of Directors (or equivalent body)
- Communication of procedures/guidelines to employees and agents

Best Practices cont.

Information Privacy Policy Considerations:

- Assess and monitor point of origin, access, use and chain of control of information received by your business
- Assess Information Disclosure Practices (e.g., do you disclose to nonaffiliated third parties, affiliates, for third party marketing?)
- Determine your Obligations to provide Privacy Notices/Opt-Outs and Procedures for Delivery and Updates

Best Practices cont.

Information Security Program Objectives:

- **Insure the security and confidentiality of information;**
- **Protect against anticipated threats or hazards to the security or integrity of customer information; and**
- **Protect against unauthorized access to or use of information that could result in substantial harm or inconvenience to any customer.**

Safeguards should be reasonably designed to achieve these objectives

Best Practices cont.

Information Security Program Elements

- Secure Storage/access restriction (electronic or otherwise)
- Information systems control (using technology consistent with current industry standards)
- Employee Training/Confidentiality Obligations
- Restriction of information access to employees who “need to know”
- Agent confidentiality/compliance procedures
- Periodic Risk Assessment
- Regular testing/monitoring

Best Practices cont.

Information Security Program Elements cont.

- Vendor/Service Provider Arrangements- contractual commitments (confidentiality, use restrictions, oversight mechanisms/audit rights)
- Incidents of unauthorized access/security breaches
 - response program (procedures, crisis management/preparedness, internal investigation, identify root cause of vulnerability, identify compromised data, assess damages (actual/potential), engage technical resources if applicable, analyze extent of past exposure)
 - damage control/mitigation
 - notifications to consumers and/or regulators
 - work with law enforcement

Conclusion

- Technical
- Not fully defined
- Evolving
- Consumer Protection
- Best Practices

THANK YOU!

Donald J. Mosher

212-756-2187

donald.mosher@srz.com

Jessica Sklute

212-756-2180

jessica.sklute@srz.com

Schulte Roth & Zabel LLP

919 Third Avenue

New York, NY 10022

212-756-2000

<http://www.srz.com>