ELECTRONIC BANKING LAW AND COMMERCE REPORT

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The Fed's E-Sign Regulations: More Questions than Answers for Disclosures in Consumer Transactions

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In enacting the Electronic Signatures in Global and National Commerce Act (the E-Sign Act or Act),[1] Congress generally gave electronic documents and electronic signatures the same validity as paper documents and handwritten signatures under both federal and state law. Recognizing concerns expressed by consumer advocates that the legislation should not be used as a means of avoiding disclosure obligations under existing law, the E-Sign Act includes a special consent procedure that must be followed before a creditor, financial institution (FI), or other company may electronically provide disclosures that otherwise must be made in writing. The special consent procedure in the E-Sign Act is referred to in this article as the "Consumer Consent Rule."

The E-Sign Act is self-executing, meaning that no regulatory action is needed to make it effective. As of October 1, 2000, when most of the Act's provisions went into effect, a company could begin making electronic disclosures by following procedures set out in the Act. Many creditors and other FIs have already begun to do so.

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The Fed's E-Sign Regulations. . .

(continued from page 1)

In March 1998 and again in September 1999, before the E-Sign Act was enacted, the Board of Governors of the Federal Reserve System (Board) had proposed electronic disclosure amendments to its consumer protection regulations — Regulation B (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers), Regulation M (Consumer Leasing), Regulation Z (Truth in Lending) and Regulation DD (Truth in Savings). The Regulation E rule was issued as a final interim rule, largely to permit banks to begin imposing surcharges for using another bank's automated teller machines and disclose the surcharge at the terminal.

When does the E-Sign Act require consumer consent?

1. When a statute, regulation, or rule of law ***requires*** . . .
2. That the information be provided or made available to ***a consumer***. . .
3. ***In writing***.

The Board delayed final adoption of the amendments to the other regulations, apparently in response to objections from consumer groups who believed that they would undermine important consumer protections. Some industry representatives, while favoring regulatory guidance, believed that compliance would have been cumbersome. These were among the factors that motivated the financial services industry to push for federal legislation on the issue.[2]

In late March and early April 2001, the Board issued a series of interim rules interpreting the E-Sign Act as it applies to the same consumer protection regulations. In the Interim Rules, as discussed below, the Board interprets the E-Sign Act narrowly and its own regulatory powers broadly.

No Consent Required for Application and Pre-Application Disclosures

Under the Interim Rules, disclosures made on or with an application for credit do not require consumer consent as a condition to their electronic distribution. This is good news for consumer creditors because the E-Sign Act could be read to require them to obtain consumer consent before making application and pre-application disclosures electronically.

As shown in Table 1 (*see* page 4), however, Regulation Z (Truth in Lending) and Regulation B (Equal Credit Opportunity) require disclosures on or with the application. Under the Interim Rules, *application and pre-application disclosures must be made before or after the application form appears on the screen (with a reference to them on the application itself), or through a link that is structured so that consumers cannot avoid the disclosures before submitting an application.* (This requirement is noted in Table 1 as the "Electronic Application Disclosure Rule.")

The decision not to require consent for disclosures made before or in conjunction with an application comes as a relief to many creditors and FIs. They prefer not to apply the Consumer Consent Rule before the consumer is committed to the transaction, believing that consumers would find the disclosures intrusive and confusing. In addition, some consumers might mistakenly believe that in being asked for their consent to electronic disclosures, they are binding themselves to the underlying transaction rather than merely to a method of disclosure delivery. Many creditors believe that the burden of reviewing and absorbing the E-Sign consent disclosures too early in the process of shopping for credit could cause consumers to opt out of electronic delivery and signature systems that could benefit them.

Two ways to make application and pre-application disclosures electronically–

1. Before or after application form appears on the screen (application must refer to disclosure).
2. Through a link (consumer must be forced to view the disclosures before submitting application).

Consumer groups, on the other hand, fear that consumers who have not agreed to receive disclosures electronically rather early in the credit process will overlook important online disclosures. The Board thus attempts, through the Electronic Application Disclosure Rule, to ensure that every consumer receives the disclosures. These attempts may be insufficient to mollify consumer advocates who have generally been skeptical that electronic disclosures can adequately substitute for paper ones.

Legal Basis

While creditors are likely to be pleased with the Board's conclusion that consent is not required for application and pre-application disclosures, they may be less satisfied with the legal reasoning behind it.

Table 1
Selected Provisions of Interim Electronic Disclosure Rules on Application and Pre-Application Disclosures

The Electronic Application Disclosure Rule, referenced several times in this Table, requires that: *application and pre-application disclosures must be made before or after the application form appears on the screen (with a reference to them on the application itself), or through a link that is structured so that consumers cannot avoid the disclosures before submitting an application.*

Statute/Regulation	Provision	Interim Rule	Previous Regulation
Truth in Lending Act/Regulation Z	Credit and charge card applications (where application is made available without a specific consumer request) and pre-approved credit and charge card solicitations[9]	Annual percentage rate (APR) on variable-rate disclosures must have been in effect within previous 30 days	APR on variable-rate disclosures must have been in effect within 60 days of mailing for direct-mail disclosures and within 30 days of publication for disclosures in catalogs and publications
		See Electronic Application Disclosure Rule, above	Similar but current guidance is contained in Commentary; Interim Rule includes it in regulation as well
	Home equity line of credit disclosures[10]	*See* Electronic Application Disclosure Rule, above (Consumer must be able to access all disclosures at time application is provided, including the Board brochure, *When Your Home Is On the Line*)	Does not specifically address electronic disclosures
	Adjustable-rate mortgage (ARM) applications[11]	*See* Electronic Application Disclosure Rule, above (Consumer must be able to access all disclosures at time application is provided, including the Board brochure, *Consumer Handbook on Adjustable Rate Mortgages*)	Does not specifically address electronic disclosures

Table 1 (continued)
Selected Provisions of Interim Electronic Disclosure Rules on Application and Pre-Application Disclosures

Statute/Regulation	Provision	Interim Rule	Previous Regulation
Equal Credit Opportunity Act/Regulation B	Disclosure of applicant's right to receive copy of appraisal report[12]	*See* Electronic Application Disclosure Rule, above	Does not specifically address electronic disclosures
	Disclosures in connection with request for monitoring information in residential mortgage loans[13]		
	Disclosure of small-business applicant's right to obtain reasons for adverse action[14]		
Truth In Savings Act/Regulation DD	Account disclosures provided on request	*See* Electronic Application Disclosure Rule, above	Does not specifically address electronic disclosures

The Board has concluded that disclosures made before an application is submitted to a creditor, and disclosures made on an application itself are not disclosures "relating to a transaction," and are thus not subject to the Consumer Consent Rule. In addition to federally required disclosures, creditors and FIs are also subject to state laws and regulations that require written application and pre-application disclosures. If these are not subject to the E-Sign Act as the Board's Interim Rule suggests, then creditors may not be able to provide them electronically under state laws that require "written" notices. The problem is obvious: a creditor might be able to provide electronic disclosures under federal laws but have to provide written disclosures under state laws if the state-mandated disclosure is deemed to be related to the transaction. This incongruity of state and federal disclosure procedures would undermine the benefits of E-Sign and create confusion both for industry's compliance efforts and among consumers.

The definition of a "transaction" in the E-Sign Act is extremely broad: "[A]n action or set of actions relating to the conduct of business, consumer, or commercial affairs between two or more persons. . . ."[3] Activities such as completing an application for credit or opening a deposit account would fall within this definition, as they relate to the conduct of consumer affairs between a consumer and a lender or FI; thus, it appears that the E-Sign Act applies even at the application stage. As an alternative to the argument that pre-application and application disclosures do not relate to a transaction, there are two other legal bases that the Board could use to avoid requiring consumer consent for electronic disclosures.

First, the statute can be read as establishing a "baseline" level of acceptance of electronic records as substitutes for written ones, which cannot be overridden by any other statute, regulation, or rule of law. The E-Sign Act permits electronic disclosures, with proper consent, under any "statute, regulation, or other rule of law [that] *requires* that information

relating to a transaction or transactions . . . be provided or made available to a consumer in writing."[4] Furthermore, the Act states that it does not:

> limit, alter, or otherwise affect any requirement imposed by a statute, regulation, or rule of law relating to the rights and obligations of persons under such statute, regulation, or rule of law other than a requirement that contracts or other records be written, signed, or in nonelectronic form.[5]

This provision implies that an agency may eliminate an existing regulatory requirement that a record be in writing, assuming that it has the power to do so. If so, the Board could arguably exercise its broad regulatory powers under the consumer laws that it administers[6] to eliminate requirements that disclosures be made on paper, taking those disclosures outside of the scope of the E-Sign Act. This interpretation finds support in the legislative history of the Act.[7]

Second, even if the E-Sign Act were read as limiting the Board's power to permit electronic disclosures directly under the laws it administers, the Act itself permits the Board, after notice and an opportunity for public comment, to exempt a disclosure from the consent requirements: "[I]f such exemption is necessary to eliminate a substantial burden on electronic commerce and will not increase the material risk of harm to consumers."[8] Thus, the Board could arguably achieve the result it intends—permitting application and pre-application disclosures to be made without following the E-Sign Act consent procedures—without concluding that these disclosures are not subject to the E-Sign Act.

Limited Alternatives for Delivering Disclosures

In the Board's view, disclosures that must be made after an application is submitted are subject to the E-Sign Act, and consumer consent is required before a creditor or FI can make them electronically. The Interim Rules give creditors two alternatives for making these disclosures:

1. Send the disclosure to the applicant's "electronic address" (which is defined as a publicly-available address rather than one that is "limited to receiving communication transmitted solely by the creditor"[15]); or
2. Post the disclosure on the creditor's Web site or another location, notify the applicant by e-mail or postal mail notice that the disclosure is available (providing the address where it can be retrieved and identifying the account number), and leave the disclosure on the Web site for 90 days.

The second alternative, in which the disclosures themselves need not be included in the e-mail, is particularly helpful to creditors and FIs that may be reluctant to send sensitive information via e-mail. With current technology, a Web site offers superior security to e-mail. Security is a particularly important consideration with regard to sensitive disclosures such as the adverse action notices required under Regulation B and the details about loan terms that must be disclosed under Regulation B.

Two ways to make electronic disclosures

1. Send to public e-mail address (no return receipt necessary).
2. Post on Web site for 90 days and send e-mail notice of availability.

In addition, e-mail systems vary in their ability to receive attachments and to recognize formatting, and in the maximum size of messages that they can accept. The second alternative allows creditors and FIs to send a short message—readable by virtually all e-mail systems—directing the consumer to more detailed disclosures on the Web site. The second alternative makes it feasible to make disclosures to a consumer who is using a device, such as a cell phone or personal data assistant, which is not capable of accepting the extensive disclosures required under several of the regulations or of saving or printing them.

In its present form, however, the Interim Rules present problems for creditors and FIs that may be using other methods to make disclosures, under their own interpretations of the E-Sign Act. For example, the E-Sign Act on its face permits a creditor or FI to make disclosures in "real time" during the course of a Web session. In the absence of the Interim Rule, a creditor could apparently comply with rules such as the adverse action requirements of Equal Credit Opportunity Act and Regulation B by providing a combined notice of adverse action/notice of reasons online, as soon as the applicant clicks on the "Submit" button.

Before the Board issued the Interim Rules, a number of creditors and FIs had begun making such "real time" disclosures. That approach has advantages for consumers as well as for creditors and FIs. For example, a consumer who receives Truth in Lending, Truth in Savings, or Electronic Fund Transfer Act disclosures while online may decide to shop elsewhere or to request a different type of product before committing to the transaction. To the extent that consumers are able to use the disclosures for shop-

Table 2
Examples of Disclosures Thay May be Made Electronically (With Consumer Consent) Using One of the Two Alternatives

Statute/Regulation	Disclosure
Truth in Lending Act/Regulation Z	• Initial closed-end disclosures (including notice of right of rescission) • Closed-end notice of ARM rate or payment change • Open-end initial disclosures, notices of change, and periodic statements
Fair Credit Billing Act/Regulation Z	• Annual statement of billing rights • Acknowledgement of billing dispute
Equal Credit Opportunity Act/Regulation Z	• Notification of adverse action • Statement of reasons for adverse action (or confirmation of oral statement of reasons)
Electronic Fund Transfer Act/Regulation E	• Initial disclosures • Periodic statements • Annual error-resolution notice • Explanation of results of investigation
Truth In Savings Act/Regulation DD	• Account disclosures (at opening) • Change-in-terms notices
Consumer Leasing Act/Regulation M	• Initial disclosures

ping purposes, one of the major goals of consumer disclosure laws can be achieved. Facilitating shopping is a goal that has often been difficult to achieve in the paper environment.

Legal Basis

As with the application and pre-application disclosures, the legal basis for the Board's action raises significant questions. Restricting creditors and FIs to two methods of electronic delivery seemingly goes beyond the "baseline" requirements of the E-Sign Act, which allows them to use any delivery method once they obtain consumer consent. The basis for the Board's action seems to be the following provision of the E-Sign Act:

> Nothing in this title affects the content or timing of any disclosure or other record required to be provided or made available to any consumer under any statute, regulation, or other rule of law.[16]

The Board seems to view this provision as taking all content and timing requirements out of the scope of the E-Sign Act, so that it may impose content and timing restrictions on electronic disclosures that are different from, and more restrictive than, those that apply to written ones. A contrary view, held by many creditors and FIs, is that this is simply a savings provision designed to ensure that the content and timing requirements for electronic disclosures are equivalent to those for the written notices that they replace. There is support for the "savings-provision" view in a Senate floor statement by several of the Democratic co-sponsors of the legislation, who generally supported increasing the law's consumer protections.[17]

If the language quoted above is merely a savings provision, then the Board may not restrict creditors and FIs to only two delivery alternatives. But there is a good argument that the Board could provide the two choices as a safe harbor that does not preclude

creditors and FIs from using other electronic delivery methods. As noted above, if the Act is viewed as providing a baseline of acceptable methods of electronic disclosure, then regulators are free to exercise other, pre-existing powers to authorize electronic disclosures.

Conclusion

The Board's Interim Rules for electronic disclosures provide useful guidance to creditors and FIs in some respects. Most significantly, the Board has clarified that E-Sign Act consent is not necessary for application and pre-application disclosures. This interpretation allows creditors and FIs to present the information to consumers in a comprehensible manner that does not disrupt the application process. Unfortunately, however, the uncertainty created by the lack of a firm legal basis for the Board's position reduces its value and raises questions about the scope of the E-Sign Act at the state level.

Similarly, the Interim Rule gives creditors and FIs two useful alternative methods of providing electronic disclosures. Restricting them to those alternatives, however, puts creditors and FIs that have been making their disclosures in other ways in a difficult position and could prevent some of them from continuing to offer online financial services. The Board's delivery rules also raise significant legal questions, reducing the value of the new rules as guidance for creditors and FIs. ■

Notes

1 Pub. L. No. 106-229, 106th Cong., 2d Sess., 114 Stat. 464 (2000), *to be codified at* 15 U.S.C. §§ 7001 *et seq.*
2 Other factors included a desire for a single, uniform nationwide standard for state-mandated disclosures and the fact that other federal agencies responsible for consumer regulation had not proposed any regulatory basis for electronic disclosures.
3 *See* Section 106(13) of the Act.
4 Section 101(c) of the Act (emphasis added).
5 Section 101(b) of the Act.
6 *See, e.g.*, Section 105(a) of the Truth in Lending Act:
> The Board shall prescribe regulations to carry out the purposes of this title. Except in the case of a mortgage referred to in section 103(aa) ["high-cost" mortgages subject to the Home Ownership and Equity Protection Act], these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

7 *See* Colloquy between Sens. Gramm and Abraham, 146 Cong. Rec. S5282 (June 16, 2000).
8 *See* Section 104(d) of the Act.
9 12 C.F.R. § 226.5a.
10 12 C.F.R. § 226.5b.
11 *See* 12 C.F.R. § 226.19(b).
12 *See* 12 C.F.R. § 202.5a(a)(2)(i).
13 *See* 12 C.F.R. § 202.13(c). The regulation refers to 12 C.F.R. § 202.13(a), but the disclosure requirement is contained in § 202.13(c).
14 *See* 12 C.F.R. § 202.9(a)(3)(i)(B).
15 *See, e.g.*, Amended Official Staff Commentary to Regulation B, § 17(d)(1)-1, 66 Fed. Reg. at 17786.
16 E-Sign Act § 101(c)(2).
17 *See* Statement of Sens. Sarbanes, Hollings, and Wyden, 146 Cong. Rec. S5228 (June 15, 2000).