Preauthorized Payments and Regulatory Compliance
Optimize preauthorized ACH and debit card payments for regulatory compliance

Recently there has been some confusion in the industry about authorizations for Preauthorized ACH and Debit Card payments under Regulation E and NACHA regulations. Some sources are distributing incorrect information. PaymentVision has prepared a detailed analysis of these requirements, relying on and quoting only authoritative sources.

1. Regulation E Requirements
Regulation E includes an authentication requirement for preauthorized electronic funds transfers. The relevant section at 12 CFR 205.10 states:

Preauthorized electronic fund transfers from a consumer’s account may be authorized only by a writing signed or similarly authenticated by the consumer. The person that obtains the authorization shall provide a copy to the consumer.\(^1\)

Regulation E thus allows two forms of authorization. A consumer authorization may be either:

1. Signed; or
2. Similarly Authenticated.

The first option, obtaining a physical signature, is logistically more difficult and may delay processing the transaction as agreed. Thus, an electronic or “similarly authenticated” authorization is often desirable. When taking that approach, the payee is responsible for ensuring that the authorization has been “similarly authenticated.”

To simplify compliance, the Federal Reserve Board’s Official Staff comments on Regulation E define a “safe harbor” for meeting this “similarly authenticated” requirement. Basically, the Federal Reserve considers any electronic authorization that meets the requirements of the federal Electronic Signatures in Global and National Commerce Act (15 U.S.C. 7001 \textit{et seq.}) (the “E-Sign Act”) to be “similarly authenticated.” The published Federal Reserve comments state: The similarly authenticated standard permits signed, written authorizations to be provided electronically. The writing and signature requirements of this section are satisfied by complying with the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001 \textit{et seq.}, which defines electronic records and electronic signatures. Examples of electronic signatures include, but are not limited to, digital signatures and security codes. A security code need not originate with the account-holding institution. The authorization process should evidence the consumer’s identity and assent to the authorization. The person that obtains the authorization must provide a copy of the terms of the authorization to the consumer either

\(^1\) 12 CFR 205.10, available at: http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&SID=ab8de1a71dd68a8ab2c2bef04bd3ac33&rgn=div5&view=text&node=12:2.0.1.1.6&idno=12.
electronically or in paper form. Only the consumer may authorize the transfer and not, for example, a third-party merchant on behalf of the consumer.\(^2\)

Operating in accordance with the Federal Reserve staff comments provides protection from liability under Sections 915 and 916 of the EFTA for financial institutions and persons subject to these laws.\(^3\)

Confusion may arise from reliance on outdated Federal Reserve comments. Prior to 2007, the comments prohibited recorded telephone authorizations for recurring transactions. However, the Federal Reserve recognized that this comment was not consistent with the E-Sign Act and removed this prohibition.\(^4\)

As can be seen, the Federal Reserve comments state that electronic authorization is acceptable, and identify two key aspects of providing a valid electronic signature:

1. Identification – validating the identity of the person giving the electronic signature; and
2. Assent – obtaining evidence that the person intends to authorize the transactions.

CONCLUSION: An authorization will satisfy Regulation E requirements for preauthorized electronic funds transfers, provided the consumer is properly identified, consents to the transfers, and the method of obtaining and recording consent complies with the E-Sign Act (including the option of telephone authorization). No actual signature is required.

2. E-Sign Act Requirements
The E-Sign Act authorizes use of both an “electronic signature” and “electronic record” in a legal contract:

[W]ith respect to any transaction in or affecting interstate or foreign commerce...(2) a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.

The E-Sign Act broadly defines an “electronic signature” as “an electronic sound, symbol, or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record.”\(^5\) The E-Sign Act broadly defines a “record” as “information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.”\(^6\) Thus, an audio recording that is stored electronically and is retrievable in a form that can be perceived (heard)

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\(^2\) 12 CFR 205 (Supp. I) ¶10(b)(5). Available online at: http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&SID=ab8de1a71dd68a8ab2c2bef04bd3ac33&rgn=div9&view=text&node=12:2.0.1.1.6.0.3.20.12&idno=12

\(^3\) 15 U.S.C. 1693m(d)(1).


\(^6\) 15 U.S.C. 7006 (9).
constitutes a “record” under the E-Sign Act. There are no other specific requirements in the E-Sign Act for electronic signatures via telephone.

In addition, the legislative history of the E-Sign Act demonstrates that Congress intended that a voice recording is not only an electronic signature, it is a very effective electronic signature:

It should be noted that Section 101(c)(6) [of E-Sign] does not preclude the consumer from using her voice to sign or approve that record. Proper voice signatures can be very effective in confirming a person’s informed intent to be legally obligated. Therefore, the consumer could conceivably use an oral or voice signature to sign a text record that was required to be given to her “in writing.” Moreover, the person who originated the text record could authenticate it with a voice signature as well. The spoken words of the signature might be something like “I Jane Consumer hereby sign and agree to this loan document and notice of interest charges.”

CONCLUSION: The broad language of the E-Sign Act permits a verbal statement of acceptance to be an electronic signature, if the person making the statement intends it as a binding agreement. A valid record of a transaction may be kept in electronic form, such as an audio recording.

3. NACHA Requirements and Guidelines

NACHA, the governing body of the ACH network, is the foremost authority on ACH transaction compliance. NACHA confirms in its published rules that electronic authorizations are acceptable under Regulation E and the E-Sign Act. The NACHA rules state:

The Similarly Authenticated standard permits signed, written authorizations to be provided electronically. These writing and signature requirements are satisfied by compliance with the Electronic Signatures in Global and National Commerce Act (15 U.S.C. 7001 et seq.).

To satisfy the requirements of Regulation E and the NACHA Operating Rules, the authentication method chosen must evidence both the consumer’s identity and his assent to the authorization. Examples of methods used to similarly authenticate an authorization include, but are not limited to, the use of digital signatures, codes, shared secrets, PINs, etc. Authentication of an authorization is strongest when the authorization and the authentication of that authorization occur simultaneously or nearly simultaneously.

The NACHA rules proceed to make it clear that the “Similarly Authenticated” standard can be met by obtaining telephone authorization:

Authorization of TEL Entries

An originator must satisfy the requirement for authorization of a TEL Entry by obtaining oral authorization from the Receiver to initiate a debit Entry to a Consumer Account of the Receiver. The authorization must be readily

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7 146 Cong Rec S 5281, 5284 (June 16, 2000)(Senate Conference Report on the E-Sign Act)
8 NACHA 2013 Operating Guidelines, Section II – ODFI, Chapter 16—Relationship with Receiver and Authorization Requirements, at p. OG64.
identifiable as an authorization and must have clear and readily understandable terms.

The following minimum information must be included as part of the authorization of a recurring TEL entry:

(h) the amount of the recurring transactions, or a reference to the method of determining the amounts of recurring transactions;
(i) the timing (including the start date), number, and/or frequency of the electronic fund transfers, or other similar reference, to the Consumer’s account;
(j) the Receiver’s name or identity;
(k) the account to be debited;
(l) a telephone number for Receiver inquiries that is answered during normal business hours; and
(m) the date of the Receiver’s oral authorization.

For an authorization relating to recurring TEL entries, the Originator must comply with the requirements of Regulation E for the authorization of preauthorized transfers, including the requirement to send a copy of the Authorization to the Receiver.9

Finally, NACHA rules impose further specific requirements for maintaining audio recordings for authorizations received by telephone:

For recurring TEL Entries, an Originator must retain for two years from the termination or revocation of the authorization (i) the original or a duplicate audio recording of the oral authorization, and (ii) evidence that a copy of the authorization was provided to the Receiver in compliance with Regulation E.10

NACHA also provides detailed guidelines for authentication of a consumer by telephone for purposes of Regulation E compliance11 (see attached Appendix).

Clearly NACHA’s rules would not provide detailed guidance and authority for telephone authorization of preauthorized electronic funds transfers, if this approach was contrary to current industry standards and applicable law.

CONCLUSION: NACHA rules confirm that telephone authorizations are acceptable for preauthorized transfers, and provide specific compliance guidelines that should be followed.

4. SUMMARY RECOMMENDATIONS: Taking Regulation E, Staff Commentary on Regulation E, The E-Sign Act, and the NACHA Operating Rules into consideration, we recommend the following process for recurring Consumer Debit Card and ACH transactions:

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10 NACHA 2013 Operating Rules, Subsection 2.5.15.3, Retention of the Record for Authorization of TEL Entries, at p. OR20.
11 NACHA 2013 Operating Guidelines, Appendix H.
1. Both authentication and authorization should be recorded and a copy of this recording must be kept for two years after the last transaction in the series.
   
a. The authentication method chosen must provide commercially reasonable confirmation of the consumer’s identity. Examples of methods used for verbal authentication that the person on the phone is the account holder:
   1. Giving a password or PIN previously used by the consumer to access the account, or provided in a previous communication.
   2. Verifying shared secrets, such as account details, payment history, or partial Social Security numbers.

b. The consumer’s verbal authorization for the transactions must clearly indicate their agreement and understanding.

c. Both the verbal authorization script and the written confirmation of authorization must meet the minimum requirements set forth in the ACH rules, to include:
   i. The amount of the recurring transactions, or a reference to the method of determining the amounts of recurring transactions.
   ii. The timing (including the start date), number, and/or frequency of the electronic fund transfers, or other similar reference, to the Consumer’s account.
   iii. The Receiver’s name or identity.
   iv. The account to be debited.
   v. A telephone number for Receiver inquiries that is answered during normal business hours.
   vi. The date of the of the Receiver’s oral authorization.

2. A confirmation of the authorization must be promptly sent to the consumer. This can be done by mail, or by e-mail if consent is obtained in conformance with requirements in the E-Sign Act.

3. Notice of transfers varying in amount.
   a. A notice must be sent out 10 days prior to the scheduled settlement date of any preauthorized transaction that will vary in amount from the previous transfer under the same authorization or from the preauthorized amount.

This compliance information is considered accurate, but is provided for information purposes only and does not constitute legal advice. Information is current as of January 16, 2015.

For More Information
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