FEDERAL RESERVE SYSTEM

[Docket No. R-1105]

Study of Banking Regulations Regarding the Online Delivery of Financial Services

Agency: Board of Governors of the Federal Reserve System.

Action: Notice; Request for comment.

Summary: Pursuant to section 729 of the Gramm-Leach-Bliley Act (the GLB Act or Act), the Board is conducting a study and preparing a report about its banking regulations with respect to the online delivery of financial services. To assist this review of its regulations, the Board requests comment on whether any of its regulations should be amended or removed in order to facilitate online banking.

For further information contact: Stephanie Martin, Assistant General Counsel, Legal Division, (202) 452-3198; Thomas E. Scanlon, Senior Attorney, Legal Division, (202) 452-3594; Heidi Richards, Assistant Director, Division of Banking Supervision and Regulation, (202) 452-3598; Jane Ahrens, Senior Counsel, Division of Consumer and Community Affairs, (202) 452-2412; Minh-Duc Le, Attorney, Division of Consumer and Community Affairs, (202) 452-3667; Jeff Stehm, Assistant Director, Division of Reserve Bank Operations and Payment Systems, (202) 452-2217.

Dates: Comments must be received by August 20, 2001.

Address: Comments should refer to Docket No. R-1105 and may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, D.C. 20551, or mailed electronically to regs.comments@federalreserve.gov. Comments addressed to Ms. Johnson also may be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m. and to the security control room accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in Room MP-500 between 9:00 a.m. and 5:00 p.m., pursuant to § 261.12, except as provided in § 216.14, of the Board's Rules Regarding the Availability of Information, 12 CFR 261.12 and 261.14.

Supplementary Information:

Background

Section 729 of the GLB Act requires the Board, the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision (the Agencies), to conduct a study of banking regulations regarding the online delivery of financial services.[1] Section 729 further requires the Agencies to report their recommendations on adapting existing legislative or regulatory requirements to online banking and lending.

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[1] Pub. L. 106-102, 113 Stat. 1476 (1999).

In accordance with section 729, the Board is reviewing its regulations that relate to the delivery of financial services to assess their suitability for transactions that are conducted through the Internet. The Board plans to consult with the other Federal banking agencies about the appropriate aims and scope of its review and will coordinate its report with those that will be produced by the other Federal banking agencies.[2] The purpose of this notice is to invite public comment on a wide range of issues that bear on delivering financial products and services over the Internet to assess whether any Board regulations should be amended in order to facilitate online banking. In addition, the Board requests comment on how particular statutory provisions affect the online delivery of financial products or services.

The Board recently requested comment on five interim final rules to establish uniform standards for the electronic delivery of notices to consumers, namely: Regulations B (Equal Credit Opportunity), E (Electronic Fund Transfers), M (Consumer Leasing), Z (Truth in Lending), and DD (Truth in Savings).[3] In connection with comments sought on those interim final rules, the Board also requested comment on whether other legislative or regulatory changes are needed to adapt current requirements to online banking and lending. In particular, the Board has requested comment on revising its regulations to facilitate electronic delivery of financial products and services to individual consumers, such as the provisions regarding periodic statements under Regulations E, Z, and DD. (Comments on those interim final rules must be received by June 1, 2001.) Any comments submitted in connection with the review of those regulations to facilitate electronic delivery of financial products and services for individual consumers shall also be considered for the study and report under section 729 of the GLB Act.

Issues for Comment

The Board recognizes that using electronic technology to deliver financial products and services poses distinct challenges to financial institutions and their customers. Much of the legislative and regulatory framework that governs banking was developed based on social, cultural, and technological practices that existed before the advent of widespread computer-based communications. The prospect of conducting banking transactions over the Internet has forced reconsideration of the existing legislative and regulatory framework that governs banking businesses.

The Board invites comment on how particular statutes, regulations, or supervisory policies specifically affect financial institutions and their customers' uses of new technologies. The following discussion identifies topics that the Board believes are appropriate for the design of the study and report required under section 729. Commenters are invited to respond to the questions presented and to offer comments or suggestions on any other issues related to financial products or services delivered online that are not described herein.

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[2] The OCC issued an advance notice of proposed rulemaking and requested comment on a wide range of electronic banking issues to determine whether the OCC's regulations should be changed to facilitate national banks' use of new technologies. 65 FR 4895 (February 2, 2000). The Board notes that the OCC specifically requested comment in connection with its study of its regulations under section 729, and the Board will review those comments in connection with the Board's own study.

[3] 66 FR 17779 (April 4, 2001); 66 FR 17786 (April 4, 2001); 66 FR 17322 (March 30, 2001); 66 FR 17329 (March 30, 2001); 66 FR 17795 (April 4, 2001).

Laws and regulations that affect transactions

Do any of the Board's regulations, such as those governing payment transactions, negatively affect the ability of financial institutions to offer certain online financial services? Which regulations, if any, negatively affect the likelihood that an individual or business customer would choose to obtain financial products or services through the Internet?

The ways in which financial institutions themselves obtain services from other financial institutions, including Federal Reserve Banks, significantly affects the products and services that financial institutions may, in turn, provide to their non-bank customers. The Board also requests comment on the specific ways in which laws, regulations, and other supervisory policies affect the online delivery of financial products and services between financial institutions.

Geography and time considerations

Some aspects of the Board's banking regulations, as well as other banking laws, are predicated on conceptions of geography. For example, bank mergers and acquisitions are regulated, in part, by legal standards that have been developed to determine whether a transaction poses anti-competitive consequences in the relevant geographic market for the cluster of banking products.[4] Similarly, the legal standards that apply to the location of bank branches depend on certain conceptions of geography.[5] How should these kinds of regulatory provisions be revised (if at all) to more appropriately govern the location of online banking and lending activities?

Other laws or regulations contain concepts of time that may not be relevant in an online environment. For example, the term "banking day" in Regulation CC is defined as that part of any business day on which an office of a bank is open to the public for carrying on substantially all of its banking functions.[6] Regulation CC requires funds that must be available for withdrawal on a business day to be available at the start of business, which may be as late as 9:00 a.m. local time of the depositary bank.[7] Are these provisions appropriate in the context of a customer that opened an account and performs all banking functions online?

The Board recognizes that these traditional boundaries of geography and time may need to be reexamined in light of online banking practices that enable customers to obtain financial products and services relatively free from customary time or place constraints. Comments are invited on how particular laws and regulations may be modified to accommodate the online delivery of financial products and services under these varying conditions.

Banking and supervisory regulations and policies

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[4] United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963) (In an action challenging a proposed merger of banks under the antitrust laws, the Court held, in relevant part, that the geographic market for the cluster of banking products and services is local in nature).

[5] 12 U.S.C. 321 (requiring, in relevant part, a state member bank to obtain the Board's approval to establish certain new branches "beyond the limits of the city, town, or village in which the parent bank is located").

[6] 12 CFR 229.2(f).

[7] 12 CFR 229.19(b).

The Board invites comment on how particular regulations or supervisory policies specifically affect financial institutions and their customers' uses of new technologies. For example, are there any specific Board regulations that unreasonably interfere with the use of online technologies? Are there any supervisory policies that impose unreasonable burdens on a financial institution's design or adaptation of online technologies? Are there any regulations or other supervisory policies regarding risk management that should be clarified or amended to adequately address any particular risks associated with methods of online banking?

Electronic Signatures in Global and National Commerce Act and other Federal laws that affect online banking

The Board recognizes that the enactment of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) has addressed several important legal and regulatory issues regarding the uses of electronic media in commercial transactions.[8] For example, the E-Sign Act permits the retention of certain types of records in electronic form (subject to specified conditions) if such records are required by any other law or regulation.[9] Do any of the Board's regulations or supervisory policies require a banking organization to use or retain written forms, notices, or other records in a manner that hinders its ability to deliver financial products or services over the Internet? The Board requests comment on how particular provisions of the E-Sign Act, or any other law, affect financial institutions and their customers' ability to use (or ease of using) new technologies.

Differing legal requirements

Do certain provisions of Federal law that apply to online banking and lending practices make compliance with other provisions of State law (or laws enforced by foreign states) more costly? Are there particular aspects of conducting online banking and lending activities that could benefit from a single set of legal standards that can be applied uniformly nationwide?

Are there any inconsistencies between Federal and State laws or regulations that impede the electronic provision or use of financial products or services? For example, do State laws or regulations apply differently to state-chartered financial institutions, relative to federally chartered institutions, that conduct online banking and lending? Are there any State laws or regulations, such as licensing provisions for banking and other financial products and services, that affect the nationwide provision of financial products or services over the Internet?

By order of the Board of Governors of the Federal Reserve System, May 16, 2001.

(signed) Jennifer J. Johnson
Jennifer J. Johnson,
Secretary of the Board

[8] Pub. L. 106-229, 114 Stat. 464 (2000).
[9] § 101(d), 114 Stat. 466-67.

FDIC Federal Register Citations

August 31, 2001

Office of the Comptroller of the Currency
Public Information Room
250 E Street, N.W.
Third Floor, Mail Stop 1-5
Washington, D.C. 20219
Attention: Docket No. 01-15

Ms. Jennifer J. Johnson Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, N.W. Washington, D.C. 20551
Attention: Docket No. R 1105

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Attention: Docket No. FRO1-17888,
Comments/OES

Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, N.W.
Attention: Docket No. 2001-41

Re: Study of Banking Regulations Regarding the Online Delivery of Financial Services

Dear Madams and Sirs:

The Electronic Financial Services Council ("EFSC") [1] appreciates the opportunity to respond to the requests for comments issued by the Federal Reserve Board ("FRB"),

the Office of the Comptroller of the Currency ("OCC"), the Office of Thrift Supervision ("OTS") and the Federal Deposit Insurance Corporation ("FDIC") (collectively, the "banking agencies") in connection with their respective studies of banking regulations regarding the online delivery of financial services. The banking agencies are required by Section 729 of the Gramm Leach Bliley Act to study their respective regulations regarding the online delivery of financial services and report to Congress their findings and any recommendations for regulatory or legislative action to better facilitate the online delivery of financial services.

The EFSC commends the banking agencies for undertaking these studies and for their efforts to date to review and revise their regulations to better accommodate new electronic commerce technologies and new business strategies in the financial services industry. The members of the EFSC have experienced significant expense, delay and frustration in their efforts to offer their products to consumers via the Internet as a result of a variety of "legacy" laws and regulations designed to facilitate face-to-face, paper-based transactions, but which now stand as barriers to the electronic delivery of financial services. Although there has been significant progress in removing one of the largest impediments to financial services, the need for paper documents and pen-and-ink signatures, through the passage of federal electronic signature legislation, much remains to be done. The EFSC appreciates the opportunity to participate in the current effort of the banking agencies to study and identify areas of law and regulation that should be revised, repealed or reworked to improve the online delivery of financial products and services.

The banking agencies have raised a variety of issues in their respective requests for comment, many of which are substantial similar. The following are the EFSC's comments on some of the specific issues and questions presented by the agencies.

Electronic Signatures

The banking agencies have asked whether it is appropriate for them to issue regulations or other supervisory guidance to set forth standards for the use of electronic signatures and records pursuant to the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001 et seq. ("E-SIGN Act").

The EFSC believes that as a general matter the rules set forth in the E-SIGN Act have tremendous promise for facilitating the online delivery of banking and other financial services. In consumer transactions, the E-SIGN Act addresses the need of consumers to obtain information before agreeing to receive legally mandated disclosures as electronic records. While the EFSC believes that certain provisions of the E-SIGN Act could stand improvement, particularly those relating to the timing and methodology for delivering disclosures mandated by the E-SIGN Act in connection with consumer consent, [2] it is premature, unnecessary and, perhaps inappropriate, for the agencies to issue regulations or other supervisory guidance on these aspects of the E-SIGN Act.

The E-SIGN Act establishes a series of specific procedures that must be followed before a federal agency has authority to issue regulations interpreting the E-SIGN Act. As noted in our comment to the Board regarding its interim rules concerning the use of electronic communications to provide required notices under five consumer protection regulations (i.e., regulations B (Equal Credit Opportunity Act), E (Electronic Fund Transfers), M (Consumer Leasing), Z (Truth in Lending), and DD (Truth in Savings)), the EFSC is concerned that regulations may be issued which, while helpful in providing practical solutions to important problems with implementing electronic records and signatures, may have the unintended effect of creating future legal uncertainty for financial service providers by circumscribing the procedural requirements of the E-SIGN Act and misinterpreting provisions of the Act. [3]

Accordingly, while the EFSC reiterates its previous comments regarding the E-SIGN Act as set forth in the attached materials, and would urge the banking agencies to recommend that Congress consider appropriate technical corrections to the E-SIGN Act, we believe that regulations or other supervisory guidance interpreting the E-SIGN Act are not warranted at this time.

Differing Legal Requirements

The federal banking agencies have asked whether there are particular aspects of conducting online banking and lending activities that could benefit from a single set of legal standards that can be applied uniformly nationwide.

As a general matter, the EFSC supports the creation of clear, consistent and uniform standards for regulating financial services given the increasing national and international character of the financial services industry in the 21st century. Indeed, the EFSC strongly supported inclusion of provisions in the E-SIGN Act to ensure that it creates a nationwide minimum standard for the use of electronic records and signatures. The EFSC is concerned that there are several areas in which there is a significant risk that the states, and in some cases local governments, will adopt a patchwork of laws that will impede not only the online delivery of financial services, but the ability of financial institutions generally to offer products and services on a nationwide basis. In particular, the EFSC is concerned with the possibility that states will adopt laws

addressing the information sharing practices and lending operations of financial institutions under the guise of consumer privacy and predatory lending laws in a manner that makes compliance unduly complicated and costly and operations impractical. Already, we have seen several financial institutions abandon significant market segments as a result of unworkable, over reactive and non-uniform state laws. The EFSC urges the banking agencies to recommend that Congress adopt legislation providing for a single national standard on these and other important issues that run to the heart of the operations of national and regional financial services firms.

With respect to privacy legislation, we note that even before there has been an opportunity to assess the impact of the privacy provisions of the Gramm Leach Bliley Act, states are proposing additional privacy requirements. For the reasons described above, we believe that a patchwork of state privacy requirements will inhibit the electronic delivery of financial services. The issues surrounding privacy are not only emotional, but more complex than they would at first appear. The Council believes that there are strong arguments for adopting national standards regarding privacy and for placing a moratorium on state enactments until there is an opportunity for a thorough consideration of all the aspects of this complex issue at the federal level. This is an area where the promotion of interstate and international commerce, in our view, requires a uniform national policy.

The Need for Uniformity of Licensing Requirements

The banking agencies also have asked whether there are any state laws or regulations, such as licensing provisions for banking and other financial products and services, that affect the nationwide provision of financial products or services over the Internet. In the experience of members of the EFSC, state licensing requirements are becoming increasingly burdensome and costly, inhibiting the ability of financial institutions to offer their products and services to consumers nationwide.

By transmitting information over the Internet, a company may, from a single location, enter into a consumer transaction in any and every state. A threshold question is whether the transaction occurs in the state in which the consumer is located, or at the location from which the electronic message originated (which may not necessarily be where the company transmitting the message is physically located and licensed). Most states that we have encountered believe that the transaction is deemed to occur in the state where the consumer is located. Also, in some cases, such as residential mortgage loan transactions, state jurisdiction follows from the situs of the property securing the loan, even if neither the borrower nor the lender are residents of the situs state. As a result, insurance companies, mortgage brokers, mortgage lenders, and real estate brokers are typically required to obtain separate licenses or other regulatory approvals in each state in which they do business.

While the difficulties associated with 50 or more different licensing laws predate the existence of the Internet or the conduct of business by electronic means, the ease of access to a nationwide market made possible by new technologies such as the Internet heightens the need for greater uniformity in the licensure and regulation of financial service providers. The Gramm Leach Bliley Act of 1999 was an important step towards the elimination of unnecessary and unduly burdensome regulatory barriers for the banking and securities sectors of the financial industry. The EFSC believes similar progress must be achieved in the mortgage, insurance and real estate industries.

For example, the regulations governing the brokering, making, and servicing of residential mortgage loans, home equity loans and consumer loans vary significantly from state to state. Each state has at least one, and in some cases two or more licensing laws applicable to the mortgage business. There is no consistency of definitions of the activities subject to licensing or the categories of companies eligible for exemption from licensing. A company doing business on the Internet seeking to become licensed to offer first and second mortgage loans in all 50 states and the District of Columbia must complete 50 to 75 separate license applications, obtain multiple surety bonds, provide similar corporate, personal and financial information on its officers, directors, and investors on separate forms for each state, and undergo extensive and repetitive background investigations. Although each state reviews roughly the same information when considering license applications, there is no uniformity with respect to how the information is gathered, processed or analyzed, nor is there an effective system by which states can access the information obtained by other states to reduce the redundancies of the current system.

As a result of the inefficiencies of the multi-state licensing process, a company seeking national lending authority may require up to a year or more to obtain all the licenses required to operate. The direct cost of this process is significant as well, running as much as $500,000 or more in terms of state filing fees, bond premiums, auditors' fees, registered agent expenses, and legal fees. The indirect costs associated with the current multi-state licensing system, such as the diversion of extensive corporate and administrative resources and the opportunity costs resulting from the lengthy time to obtain nationwide authority to conduct business, are more difficult to quantify, but are undoubtedly significant as well. Corporate officers, directors and investors can expect to be called upon repeatedly to provide detailed personal, business and financial information, and to provide fingerprints for multiple criminal background investigations. In addition, once licenses are obtained, companies must incur significant costs and devote substantial administrative resources for functions related to the upkeep of licenses, including annual license renewal procedures, the completion of annual reports of lending activity and financial results, general regulatory compliance and management of state examinations, and the payment of annual fees and assessments.

To address these concerns, and reduce the substantial barriers to online delivery of financial services presented by the current system of multi-state regulation, the EFSC suggests that the banking agencies consider the feasibility of a federal non-depository financial institution charter. A federal non-depository financial institution charter could be available as an alternative to, and not a replacement of, the current system of state licensure and regulation of non-bank financial services providers. The advantages of such a charter to consumers and companies offering financial products online would be clear: companies could obtain authority to do business nationwide, and be subject to supervision and oversight, by a single, federal regulator. This would eliminate a substantial impediment to the online delivery of financial services throughout the country, while at the same ensuring consumer protection via a strong regulator and expanding access to financial services to consumers located in inner cities, rural areas and other under served markets. Moreover, because the charter would not involve deposit insurance, safety and soundness concerns would be minimized and taxpayers would not bear the risk of loss.

Alternatively, legislation could be enacted to encourage states to adopt, within a specified time period, uniform licensing laws or a system of reciprocity under which a license issued in one state is recognized in other states, provided that the laws applicable in the "home state" of the licensee meet a minimum threshold standard of regulation and oversight. Unless a significant majority of states adopt either a uniform licensing law or provide reciprocity for licenses issued in other states, it would be appropriate for a federal licensing system to be implemented to ameliorate the significant barriers to electronic commerce resulting from the current multi-state licensing system. A precedent has been set in the insurance industry for a mechanism to encourage states to adopt a uniform, national licensing system for persons who sell or solicit the purchase of insurance. The Gramm-Leach-Bliley Act contains provisions (see Sections 321-336) that require states to act within three years either to adopt uniform licensing laws or to enact reciprocity laws governing the licensing of nonresident insurance agents. If a majority of states fail to act within three years, a national registration scheme, known as the National Association of Registered Agents and Brokers ("NARAB"), will be implemented. An insurance agent who registers with NARAB would be able to be licensed in any state without regard to state residency requirements so long as the agent pays the requisite license fees and meets applicable bonding requirements. The EFSC suggests that consideration be given to extending the NARAB model to other segments of the financial services industry, such as mortgages and real estate, that are plagued by similar licensing inefficiencies inherent in the current non-uniform, multi-state licensing system.

In-State "Bricks and Mortar" Office Requirements are Unconstitutional and Clear Barriers to Electronic Commerce

In several segments of the financial services industry, a host of state laws exist which require financial service providers to maintain offices in state or employ local residents as employees or agents. While some of these laws are legacies of an era where it was valid to assume a transaction would occur in person, others were clearly intended to restrict out-of-state competition. The EFSC believes it is appropriate for the federal government to exercise its authority to regulate interstate commerce and block enforcement of these state laws that unduly burden commerce among the states and which are antithetical to the concept of the Internet as an electronic marketplace free of the expense and inconvenience of physical places of business.

In the mortgage industry, approximately 30% of states require companies that make, broker or service first or second lien, residential mortgage loans to maintain some form of instate office as a condition for becoming licensed. Among the states with these so called "bricks and mortar" requirements are Arizona, California, Georgia, New Jersey, Ohio, Pennsylvania, and South Carolina. In-state office requirements no longer serve any legitimate public policy object, such as consumer protection, and impose an undue burden on interstate commerce in the mortgage industry. Requirements for companies to maintain offices or employees in a particular state cannot be justified by business necessity and are out of sync with new technologies and business models that permit the accurate, convenient, and efficient communication of information to consumers via the Internet, centralized call centers and express mail.

Without discussing the specific bricks and mortar rules for each state, it is useful to consider the requirements in South Carolina's mortgage broker statute as an example of the burden these requirements impose on all mortgage companies operating nationally from centralized locations, using the Internet or other communications media. South Carolina law requires that a licensed mortgage broker maintain a physical place of business in the state, which, at a minimum, is staffed by at least one employee with authority to contract on behalf of the licensee and to accept service of process on the broker. The office must be open during regular business hours, which are defined as at least 30 hours a week from Monday through Friday. The state regulator must be notified of the licensee's hours of operations if the licensee's office is not open for business from at least 8:30 am to 5:00 pm, Monday through Friday.

While requirements in other states are not as well defined or onerous, the mere necessity of a physical presence in a state is a significant burden for companies doing business through electronic commerce. Companies are forced to either incur the cost of leasing offices, hiring employees and paying for equipment that they do not need and would not use but for the fact of the bricks and mortar requirement, or elect not to do business in that state. Either way, consumers are the ones that ultimately suffer as there are fewer sources of capital and less competition among lenders; and those out-of-state lenders that elect to do business in the state must incur greater expenses and do business at a competitive disadvantage, with the likely result being higher costs for consumers.

Unfortunately, in many states, the bricks and mortar requirements are not merely a case of old laws needing to be brought up to date. In the past three years, a number of states, including Alabama, Georgia, Kansas, Ohio, Texas and Wisconsin, have adopted some form of in-state office requirement for mortgage companies. In many cases, these laws are the result of lobbying efforts by local mortgage companies with the express purpose of limiting competition from lenders and brokers operating on the Internet or otherwise from out of state.

With respect to insurance sales, many states still require that a resident agent countersign policies issued by agents or insurers not domiciled in the state. Some states also have laws or other requirements that specify that a nonresident agent or producer must be accompanied by a resident producer to solicit insurance. Countersignature requirements and resident-nonresident "hand holding" requirements clearly impede the sale of insurance through electronic means and serve only as a protection of resident agent commissions.

In addition to the fact that there is no reasonable business or public policy justification to support the continuation of in-state office or resident agent requirements, a compelling legal case may be made that a state law mandating that a company operate an office instate or employ a state resident as a condition of becoming licensed or operating in the state violates the Commerce Clause of the Constitution of the United States.

It is well settled that a state law that discriminates on its face or in its effect by treating in-state and out-of-state commerce or competitors differently is per se invalid under the Commerce Clause. Hughes v. Oklahoma, 441 U.S. 322, 336 (1979); New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 274 (1988). A state law that discriminates in favor of local interests to the detriment of out-of-state businesses "invokes the strictest scrutiny of any purported legitimate local purpose, and of the absence of nondiscriminatory alternatives" and will generally be upheld only if it is the least restrictive means available to achieve a legitimate local government objective. Hughes v. Oklahoma, 441 U.S. at 337.

Federal courts considering the validity of in-state office requirements in connection with professional licenses have consistently struck down requirements that companies maintain an office in the subject state as a condition for holding a license. See, e.g. Codar, Inc. v. Arizona, No. 94-16902,1996 U.S. App. LEXIS 21356 (9th Cir. 1996) (collection agencies); Georgia Association of Realtors v. Alabama Real Estate Commission, 748 F.Supp. 1487 (M.D. Ala. 1990) (real estate brokers); Underhill Assoc., Inc. v. Coleman, 504 F.Supp. 1147 (E.D. Va. 1981) (securities dealers). Indeed, the Supreme Court has noted that state laws requiring business operations to be performed instate that could be performed more efficiently elsewhere are virtually per se illegal. See, e.g., Pike v. Bruce Church, 397 U.S. 137, 145 (1970).

The EFSC urges the banking agencies to recommend that Congress enact legislation to remove these unconstitutional, protectionist barriers to electronic commerce by expressly preempting state requirements for instate office and resident agent requirements for mortgage companies, insurance companies and other financial services providers.

Appraisals

The banking agencies have asked whether the requirement for written appraisals impairs or impedes online lending operations. To the extent that there is any doubt as to the ability of an electronic appraisal to substitute for a written appraisal, the EFSC believes that this issue has been clearly addressed by the adoption of the E-SIGN Act. The E-SIGN Act provides that with respect to any transaction in or affecting interstate commerce, a signature, contract or other record relating to such transaction may not be denied legal effect, validity or enforceability solely because it is in electronic form. Clearly, an appraisal is a record relating to a transaction - an appraisal is typically required by lenders, if not by regulation, as a condition of making a mortgage loan. Thus, because the E-SIGN Act permits the use of an electronic record wherever a writing is required, there is no need for the agencies to provide guidance on how electronic appraisals can be utilized in connection with lending transactions. Furthermore, the Appraisal Standards Board ("ASB") of the Appraisal Foundation (overseen by the Appraisal Subcommittee of Federal Financial Institutions Examination Council ("FFIEC")) issued a Statement on the Electronic Transmission of Reports (statement 8) in July 1995. This has been the "regulatory" acknowledgment that appraisals could be transmitted electronically subject to certain protections: essentially that the appraisal performed an act (similar to a signature) that indicated that he or she accepted/adopted the work as his or her own and that he or she was assured that the appraisal was transmitted and received in its original form. The ASB has recently withdrawn that statement, not because they disapproved of electronic transmissions, but felt that the practice was well enough established that the statement might be more of a hindrance than an encouragement (or a bar to future changes in technology).

The agencies have also sought comment on whether additional regulatory guidance is needed with respect to authentication of an electronic appraisal, certification of the appraiser, or other standards regarding the authenticity and integrity of electronic appraisals. The EFSC believes that the recent guidance issued by FFIEC regarding

authentication in an electronic banking environment creates a reasonable and flexible standard that should be applied expanded and applied to cover financial institutions' electronic communications with vendors, including providers of electronic appraisals. [4]

Finally, the EFSC recommends that the banking agencies consider through the FFIEC a separate process to review the feasibility of certain property valuation models as an alternative to an appraisal performed by a licensed or certified appraiser. New, automated property valuation tools are increasingly being utilized as part of automated underwriting systems to assist lenders and investors in making decisions to extend credit or purchase loans. Typically, the cost of these alternative valuation methods is substantially less than an appraisal. In light of the potential cost savings to consumers, the banking agencies should consider whether and under what circumstances these valuation tools should permitted as a substitute for a full appraisal performed by a licensed or certified appraiser.

Weblinking

Finally, the banking agencies have requested comment on whether various weblinking or hyperlinking arrangements create consumer confusion and whether further regulatory guidance is required. In the typical case, a financial institution may provide hyperlinks from its website to websites of affiliated or non-affiliated third parties that offer financial and/or non-financial products or services not otherwise offered by the institution as a means of providing users of its website access to a wider array of products or services.

While the EFSC acknowledges that the possibility of consumer confusion always exists, responsible institutions have significant incentives to avoid any misunderstanding over which entity provides which products and services. From a legal perspective, a financial institution providing weblinks would be wise to avoid any characterization that it is offering or endorsing the product or service available through the link, not only to prevent claims of liability for the product or service itself, but also to avoid questions regarding its licensing authority to broker products offered at a linked website, such as mortgages, insurance or securities. In addition, financial institutions have a significant reputational and customer relations interest in making clear their limited role when providing weblinks as they do not want to be viewed by their customers or the public as guarantors of the quality of products and services offered by third parties. Accordingly, absent an empirical showing of actual consumer confusion or harm, the EFSC believes that regulation of weblinking arrangements is not warranted at this time.

The banking agencies request for comment on weblinking highlights another concern, which is the need for consistency among federal agencies when dealing with new electronic commerce issues. The financial services industry has been awaiting guidance for many years from the Department of Housing and Urban Development ("HUD") on the applicability of the Real Estate Settlement Procedures Act ("RESPA") to many aspects of the Internet, including weblinking arrangements. The EFSC is concerned that the various statements by the OCC over the years, including most recently its proposed rule and supervisory guidance that define weblinking as a "finder" activity permissible of national banks may have the unintended effect of prejudicing consideration of weblinking arrangements under RESPA. In particular, there are substantial questions as to what type of weblinks and under what circumstances such arrangements might constitute a "referral" of real estate settlement service business for which no fees may be paid may be paid under RESPA. The EFSC urges the banking agencies to exercise caution when reviewing emerging electronic commerce business practices and consider the implications of their regulations on other laws outside their immediate interpretative jurisdiction. When appropriate, the banking agencies should consult with other federal agencies, such as HUD or the Federal Trade Commission, to ensure greater consistency and uniform treatment of a particular business practice.

The EFSC appreciates this opportunity comment on many of the important issues and questions raised by the banking agencies in connection with their studies of regulations regarding online delivery of financial services. Please contact Jeremiah S. Buckley or John Kromer at (202) 974-1000 with any questions.

Sincerely,

/SIGNED/ Jeremiah S. Buckley

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[1] The EFSC is an organization representing many of the leading companies offering financial services over the Internet. The Council's mission is to update laws and regulations to facilitate the electronic delivery of financial services (including mortgages, insurance, real estate, on-line banking services, and securities). Members include: Countrywide Home Loans, Inc., Intuit Inc., GE Capital Mortgage, Microsoft Corporation, Cendant Mortgage, Chase Manhattan Mortgage, Citigroup Mortgage, Inc., Fannie Mae, Freddie Mac, GMAC Mortgage Corporation, Lender Services, Inc., Lending Tree, The Principal Financial Group, United Guaranty Insurance, and Wells Fargo, and Esurance. Additional information about the EFSC is available on the Internet at www.efscouncil.org.

[2] As further background on the EFSC's position regarding the E-SIGN Act in general and the consumer consent provisions in particular, we have attached copies of the EFSC's comments to the Federal Trade Commission and National Telecommunications and Information Administration and its testimony before the House Financial Services Subcommittee on Domestic Monetary Policy, Technology and Economic Growth as Exhibits A, B, and C.

[3] See the EFSC's comment to the Board, attached as Exhibit D.

[4] See FFIEC, Authentication in an Electronic Banking Environment (August 8, 2001).

March 17, 2001

Secretary
Federal Trade Commission Room H-159
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Sallianne Fortunato
National Telecommunications and Information Administration
Room 4716
14th Street and Constitution Avenue,
N.W. Washington, D.C. 20230

Re: ESIGN Study - Comment P004102

To the Federal Trade Commission ("FTC"):

These comments are provided in response to your Request for Comment and Notice of Public Workshop on the Electronic Signatures in Global and National Commerce Act ("ESIGN"). The Electronic Financial Services Council ("EFSC") is a national trade association promoting legislation and regulation designed to ensure that electronic commerce continues to revolutionize the availability and delivery of financial services.

The EFSC welcomes the opportunity to comment on the benefits and burdens of requiring consumer consent to receive information electronically pursuant to Section 101(c)(1)(C)(ii). The EFSC believes that as a general matter the rules set forth in ESIGN have tremendous potential for assisting the growth of electronic commerce. Furthermore, the EFSC is firmly committed to the proposition that consumers are entitled to timely and meaningful information concerning their options and all the methods available to them for receiving required notices and disclosures. Electronic commerce cannot reach its full potential without the consumer's complete comfort with, and confidence in, both the process and the medium. Effective delivery of the ESIGN consent disclosures as set forth in Section 101(c)(1) ("ESIGN consent disclosures") will materially contribute to that comfort and confidence.

The EFSC strongly supported the original package of consumer protection provisions added to ESIGN in the House of Representatives (sometimes called the "Inslee Amendments"). The EFSC supports both (i) the requirement under Section 101(c)(1)(A) that consumers give affirmative consent to electronically receive information otherwise required to be in writing, and (ii) disclosure of the information currently mandated by Section 101(c)(1)(B).

However, the EFSC also believes that the current rules regarding the timing and methodology for delivering the ESIGN disclosures and obtaining consumer consent could be substantially improved. Certain elements of ESIGN's rules concerning effective consumer consent in Section 101(c)(1)(C)(ii) were not part of the original Inslee Amendments. Instead, they were added at the very end of the legislative process and so were, perhaps, unavoidably subjected to a less rigorous level of analysis than the rest of the statute. In particular, the consent process described in Section 101(c)(1)(C)(ii) can create unanticipated, and unintended, obstacles to the effective use of electronic commerce by both consumers and businesses. This letter will respond to a number of the questions the FTC has addressed to the financial services industry concerning the ESIGN consent procedure.

The consumer consent provisions in ESIGN Section 101 (c) lay out four principal procedural requirements:

o The consumer must be provided the "ESIGN consent disclosures";
o The disclosures must be conspicuously displayed prior to the consumer's first receipt of information which otherwise would be required to be delivered in writing ("required information");
o Having received the ESIGN consent disclosures, the consumer must consent electronically to receive the required information in electronic form; and
o There must be a "reasonable demonstration" of the consumer's ability to receive and access the file formats that will be used during the transaction.

EFSC's members are now in the process of designing and implementing a variety of products and services intended to benefit from and implement ESIGN. For the most part, these products and services are still in the planning and design stage, so that at this time the EFSC has little empirical data available concerning consumer acceptance and practical application of the ESIGN consent disclosure requirements "in the field." However, the EFSC's members do have experience in design and implementation of electronic commerce applications that are not dependent on ESIGN for validity (e.g. online lending applications, commercial data, aggregation and exchange, and agreements for provision of certain financial services), as well as significant experience with consumer reaction to those designs. Based on this experience, the EFSC's members believe that implementation of the consumer consent provisions, and in particular the electronic consent and "reasonable demonstration" requirements of Section 101(c)(1)(C)(ii), impose the following potential burdens (discussed in more detail below):

o The combination of the timing and ESIGN consent disclosure requirements may, in a number of instances, force presentation of the ESIGN consent disclosures before the customer has committed to the transaction in any form, and before the customer is prepared to choose either an electronic or written medium. An example would be the delivery of pre-application disclosures in connection with certain types of consumer credit products.

o The reasonable demonstration test requires interruption of the contracting process to establish, based on a subjective standard, the consumer's ability to access documents that are provided in formats in common use for which viewing software is freely available. The test also provides an incentive to favor certain file formats over others in order to streamline the testing process.

o The requirement of electronic consent, combined with the reasonable demonstration test, impairs the use of electronic contracting and disclosure in business models where the relationship begins with a face-to-face meeting in a commercial setting or via telephone (or some combination of the two), but both parties wish to communicate and exchange required information electronically.

o Technical violations of the rules for ESIGN consent disclosures may result in disproportionate penalties.

As noted earlier, the members of EFSC have not, in general, had a chance yet to fully test consumer acceptance of, or reaction to, the systems and processes they are designing. It is conceivable that additional issues may arise as testing continues.

It is the view of the EFSC that the information communicated to consumers in the ESIGN consent disclosures is of significant benefit to both consumers and businesses; it empowers consumers to make educated decisions regarding the transaction of business and the receipt of legally required disclosures electronically. However, the benefits associated with some of the technical and procedural requirements outlined above for the delivery of the ESIGN consent disclosures and the process for obtaining consumer consent are significantly outweighed by the burdens they impose on electronic transactions involving financial services and products. The balance of this letter will explore each of these burdens in more detail and suggest statutory solutions that would retain the most meaningful benefits of the consent provisions, while reducing the burdens. The letter will also indicate the FTC questions that are addressed in the course of the discussion.

EVALUATING THE BURDENS

Timing (Responds to FTC Questions 1, 3, 5, 6, 12, 15)

As a general matter, both ESIGN and the Uniform Electronic Transactions Act ("UETA") require the parties to an electronic transaction to agree to replace any required writings or traditional signatures with electronic equivalents. The consent can be express or implied from the circumstances. Timing is left to the parties under the UETA for all transactions and for business-to-business transactions under ESIGN. Consent may be given before the electronic records and signatures are utilized, or the use of electronic methods may be ratified at any time during the transaction or even after the transaction is concluded.

In contrast, Section 101 (c) requires the ESIGN consent disclosures to be given before the required information is provided. In some financial transactions (particularly certain types of consumer credit transactions) required information must be delivered before the consumer is committed to conclude the transaction. The presentation of the full ESIGN consent disclosures while the consumer is still evaluating the proposed transaction can be intrusive and confusing. Introducing the burden of reviewing and absorbing the ESIGN consent disclosures too early in the "shopping" process may cause consumers to reflexively opt out of efficient, cost effective electronic delivery and signature systems that could benefit them. This is particularly true in the context of an online transaction initiated by the consumer, who is actively and intentionally seeking out the required information electronically. The forced display of the detailed ESIGN consent disclosures while the consumer is still shopping interrupts the consumer's evaluation of the proposal, and may lead to the erroneous belief that the consumer is being asked to commit to the transaction itself, when all that is being sought is consent to use electronic records to effect delivery of pre-transaction required information.

Past experience with consumer reactions to online contracting strongly suggests that under these circumstances many consumers will become either frustrated or confused and abandon the transaction entirely. As a consequence, some lenders designing online systems are actively seeking ways to delay the ESIGN consent disclosures until the consumer is at the point of committing to the transaction. One way this is being done is by invoking the rules relating to telephone loan applications, so that initial delivery of required information may occur shortly after the consumer has completed the application process. In this way, the ESIGN consent disclosures do not interrupt or interfere with the consumer's evaluation of the offered loan and completion of the application. The result is that the timing of information flow to the consumer is being determined, not by consumer preference, need or convenience, but by the strictures of the timing requirements for consumer consent.

Reasonable Demonstration Test (Responds to FTC Questions 1, 3, 7, 12, 15, 26, 27)

The requirement of a "reasonable demonstration" of the consumer's ability to receive file formats is already having an impact on electronic financial services, both by (i) discouraging the use of widely available, reliable file formats, such as Adobe Acrobat PDF ("PDF") in favor of HTML and other formats native to the software delivering the ESIGN consent disclosures, and (ii) discouraging some major lenders from utilizing ESIGN at all.

One of the principal goals of any electronic information delivery process is to keep the flow of information as streamlined as possible. Experience has shown that frequent extended interruptions and downloads increase the likelihood that the consumer will abandon the transaction. As a result, EFSC members and representatives have observed a growing pattern over the last few months: a number of system designers are selecting the native file format of the software delivering the ESIGN consent disclosures (such as HTML for a web browser) as the exclusive file format for delivering all required information. This choice is made because it simplifies completion of the reasonable demonstration test, without regard to whether it is the best format for handling the documents in the transaction. Financial service providers reason that in many cases consumers will initiate electronic contact over the Internet, using a web browser, or using proprietary software provided for the specific purpose (such as bill payment or money management software). If the ESIGN consent disclosures are delivered in the software's native format, and the consumer reviews the ESIGN consent disclosures and affirmatively consents, that should constitute a "reasonable demonstration" of the consumer's ability to receive records. The consumer and service provider have not had to deal with multiple formats, and the consumer has not had to endure a complex "download and response" test.

Essentially, the reasonable demonstration test provides a disincentive to use alternative file formats such as PDF and Microsoft Word, despite the fact that these formats are highly reliable, print and store accurately across a wide variety of platforms and printers, provide an excellent medium for delivering information with the formatting intact, and may be viewed using software that is distributed free of charge and is widely available. As a result, the file format of choice is being selected by some designers based on its unobtrusive "fit" into the reasonable demonstration test, and not on an evaluation of the most appropriate and useful format for the transaction. This is ironic, given Congress' clear general intent that ESIGN be technologically neutral and not favor any one process or format for doing business electronically to the detriment of others.

In addition, uncertainty as to what constitutes a "reasonable demonstration" is persuading some businesses to avoid the use of electronic documentation entirely. The test is subjective and fact-based. This means that even if the required information is actually received and reviewed, consumers may at a later date challenge the effectiveness of the required information based on whether the test was reasonable. Furthermore, because the reasonableness of the test will usually be a question of fact, not law, there will be little opportunity for the industry to shape its testing process based on reported judicial decisions and prior case law. Representatives of the EFSC have been present at public forums where counsel to large, sophisticated lenders stated that they have advised their clients against using ESIGN because of these uncertainties.

Electronic vs. written consent (Responds to FTC Questions 1, 3, 12, 13)

The primary benefits of substituting electronic records and signatures for traditional paper-and-ink documents are the ability to better manage data, workflow, quality control, speed of delivery, and document management (storage, retrieval and transmission). These benefits accrue whether a transaction is initiated online, or initiated in person. In the financial services industry, many customers still prefer to establish a relationship with an in-person visit, but are fully prepared to accept electronic delivery of the required information that is part of the ongoing relationship. Because of the electronic consent and reasonable demonstration requirements, businesses cannot rely on a consumer's consent obtained during the initial in-person meeting. Instead, the business must provide instructions for giving consumer consent, which the consumer must keep and remember to follow at a later date. In some instances, the time for providing certain required information may be running while the business is waiting for the consumer to complete the consent process. As a result, the business must continue to send paper documents to a consumer who is slow to complete the consent procedure, even though the consumer may be ready, willing and able to receive electronic documents.

Disproportionate Penalties (Responds to FTC Questions 1, 3, 5, 11, 12, 14)

Under Section 101(c)(1)(A) and (B), a technical failure to comply with the ESIGN consent disclosure and timing requirements may result in ineffective delivery of the required information, even if the violation was not intentional and did not prevent receipt and review of the required information. If the required information is not considered effectively delivered, or consent is deemed ineffective, the provider of the required information may be exposed to significant statutory damages and other remedies associated with the substantive law underlying the transaction. For example, it might be argued that an unintentional misstatement of the fees for paper copies, or a technically incorrect statement of hardware or software requirements, invalidates both the consent and delivery of the required information, even though the inaccurate disclosure had no impact on the transaction and the required information was actually received and reviewed successfully. In the same vein, it may be argued that both consent and delivery of required information is invalidated if the presentation of the ESIGN consent disclosures is not correctly timed, even though the consumer wished to consent and actually received and reviewed the required information.

EVALUATING THE BENEFITS

Each of the consent timing and methodology requirements discussed above generates some benefit. However, upon examination it is clear that the benefits are not as significant, or as certain, as might be thought at first glance.

Timing (Responds to FTC Questions 3, 5, 17)

The object of the ESIGN consent disclosures timing rule is to prevent the use of ESIGN to force the consumer to accept electronic delivery of required information. It is also intended to prevent the use of ESIGN to render required information ineffective either because it is delivered in an obscure manner or in file formats the consumer is unable to view, download or print. In the context of required information delivered before the consumer is committed to the transaction, however, the need for such protection is attenuated, so long as the consumer has initiated the transaction online and has been notified that important information is about to be delivered electronically. If the information is delivered in an inaccessible format, or is garbled in transmission, or is otherwise unreadable, the consumer has the option of simply terminating the transaction. The past experience of EFSC members strongly indicates that consumers routinely terminate unconsummated transactions when they become frustrated or confused by the on-line process.

Reasonable Demonstration Test (Responds to FTC Questions 3, 17)

The "reasonable demonstration" test is intended to establish the ability of a consumer to receive and view the file formats being used to deliver required information. The significance of the test is diluted, however, because of other protections available to the consumer. Intentional use of obscure or unstable file formats will run afoul of state and federal laws governing deceptive trade practices and fraud. In addition, even in the case of unintentional delivery problems the consumer retains the right to rescind consent and either terminate the transaction or demand delivery of required information on paper.
In addition, the effectiveness of the test is, by definition, limited to the computer the consumer is using at the time the test is administered. Many consumers have Internet access both at home and at work, and may have multiple computers in their home. The various computers may use different operating systems, different versions of key software, or even competing software to perform the same functions. The relevancy of the test is diminished because it only establishes the ability to receive and view the files on one computer, which may not even be the computer on which the consumer principally relies. In cases where the proposed file formats are in common use, and software for viewing the file format is freely available, the test will often be no more than an unnecessary annoyance for all parties.

Electronic vs. written consent (Responds to FTC Questions 3, 17)

The primary purpose of the electronic consent requirement is to prevent consumers who do not have the ability to receive electronic records from unwittingly or unwillingly agreeing to their use for required information. This is perceived as a particular problem with respect to the homebound and the elderly. However, it is not clear what benefit this adds to a transaction initiated in a commercial establishment or by telephone, if the full ESIGN consent disclosures are provided at the time of the election. In most cases, if the transaction is occurring at a place of business it means that the consumer sought out the transaction. If the consumer is unwilling or unable to accept electronic delivery of required information, or is feeling undue pressure to accept electronic delivery, then the consumer can simply terminate the exchange.

Disproportionate Penalties (Responds to FTC Questions 3, 5, 17)

The imposition of penalties for intentional and material non-compliance with ESIGN's consent and timing requirements is both necessary and appropriate; it provides an incentive for compliance and a remedy for injured consumers. However, penalties do not accomplish either of those goals in situations where a good faith attempt at compliance has occurred, the violation is inadvertent and non-material, and the required information was actually delivered. Penalties will not prevent unintentional technical violations, and offering remedies to consumers who were not harmed by the error results in a windfall, not relief from an injury. Furthermore, the cost of settlement of actions brought in connection with unintentional technical violations is borne by all consumers.

RECOMMENDATIONS

(responds to FTC questions 2, 4, 17)

In light of the foregoing evaluation, the EFSC recommends that the following four changes be made to the ESIGN Act:

a. In circumstances where a consumer is initiating a transaction electronically and required information must be given before the consumer is obligated on the transaction, it should not be necessary to display the full ESIGN consent disclosures before providing the required information. An alternative procedure should be available, permitting the display of a brief statement requesting consent to deliver the information electronically, advising that the full ESIGN consent disclosures are available for review, and providing the consumer voluntary access to the full disclosures before proceeding. Conspicuous display of the full ESIGN consent disclosures would still be required before the consumer becomes bound to complete the transaction.

b. It should be possible to give consent either electronically, or on paper if the transaction is being initiated at a commercial location, or over the telephone. Written or telephonic consent should be preceded by the full ESIGN consent disclosures, including a disclosure of the file formats and delivery methods that will be used to provide required information to consumers.

c. The "reasonable demonstration" test should not be required when information is being provided in file formats for which free viewing software is available (examples would include HTML, PDF, or Microsoft Word), if the consumer is given notice of the availability of the viewing software as part of the ESIGN consent disclosures (this would mirror the practice on a number of federal websites, including the FTC and Internal Revenue Service sites, where files are made available for downloading in PDF format and hyperlinks are provided to obtain free PDF viewing software).

d. The consumer's consent and effective delivery of required information should not be invalidated as a result of technical violations of the ESIGN consent disclosure or timing requirements, where the required information is actually received and reviewed.

By its nature, a comment letter of this type can sometimes seem to focus on the negative. The members of the EFSC wish to emphasize that they are enthusiastic supporters of the ESIGN legislation and its potential contribution to efficiency, economic expansion, and consumer convenience. The fact that large-scale implementation of ESIGN has not yet occurred should not be read as a lack of enthusiasm for the statute or a waning of industry interest in electronic commerce. Rather, the deliberate pace reflects the determination of many responsible members of the financial services industry to act thoughtfully and to roll out ecommerce applications that are well designed and well implemented.

Sincerely,

Jeremiah S. Buckley

General Counsel

STATEMENT
OF
JEREMIAH S. BUCKLEY
ON BEHALF OF THE
ELECTRONIC FINANCIAL SERVICES COUNCIL
BEFORE THE
HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON DOMESTIC MONETARY POLICY, TECHNOLOGY AND ECONOMIC GROWTH
UNITED STATES HOUSE OF REPRESENTATIVES
June 28, 2001

Good morning, Mr. Chairman and members of the Subcommittee. My name is Jerry Buckley. I am a partner in the law firm of Goodwin Procter and I serve as General Counsel for the Electronic Financial Services Council. The Council, established in 1998, is a national trade association made up of both technology companies and traditional financial services firms dedicated to promoting legal and regulatory changes needed to facilitate electronic delivery of financial services. The Council welcomes the opportunity to comment on the operation and impact of the ESIGN Act and its consumer consent provisions on the financial services industry.

Members of the Council believe that the rules regarding electronic signatures and records set forth in the ESIGN Act have tremendous potential to promote the growth of electronic commerce, particularly in the financial services sector.

Under the ESIGN Act, consumers and businesses will be better able to access products and services 24 hours a day 7 days a week. Transaction times will be reduced. Consumers in currently under-served communities, be they urban or rural, will now have access to a competitive menu of services from a variety of financial services providers. These online consumers will receive financial disclosures in real-time, not a packet of papers mailed and received days after they commit to a financial product, as is now the case.

Imagine the luxury of exploring a financial product and related disclosures at leisure on your computer whenever you want. Pop-up boxes or hyperlinks will be available to answer frequently asked questions or explain financial jargon which you don't understand. By having a real-time, online conversation with the consumer, a financial services provider will be able to assure that the consumer is informed and committed to the product, thus avoiding costly fall-out as the transaction approaches consummation.
Beyond empowering consumers, it is hard to overestimate the savings and increased productivity which ESIGN will facilitate with respect to the management and retention of records. ESIGN will allow businesses to eliminate billions of dollars in records management costs, which savings will ultimately be competed through to consumers in the form of reduced costs for financial services.

Congress is to be congratulated for its foresight in enacting the ESIGN Act and providing the legislative infrastructure to facilitate a dramatic expansion of electronic transactions. Mr. Chairman, we are pleased that with the first anniversary of enactment of the ESIGN Act coming up in two days, you have seen fit to hold this oversight hearing on implementation of the ESIGN Act and its impact on the financial services industry.

Some have observed that financial services industry has been slower than expected in adopting the use of the electronic medium that ESIGN empowers. We believe that several factors are responsible for this phenomenon.

o First, the Act is self-effectuating, that is, it does not require a federal agency to spell out "rules of the road" and standard, mandated forms as is often the case with federal legislation, rather leaving these decisions to private parties. This flexibility, which will be very important to facilitating market innovation over the long run, has the short run disadvantage of not providing specific governmental guidance regarding appropriate electronic business procedures.

Thus, private sector parties are having to devise their own standards and specifications for conducting business electronically. Particularly in the financial services business, where financial instruments must often be capable of being traded or pledged, it is not sufficient for the financial instrument to be enforceable as between the originating parties. These instruments must be originated to the satisfaction of secondary market purchasers of mortgage or chattel paper and others who trade in or

finance such instruments. In order for this to happen, each financial services industry will have to develop a series of conventions regarding what electronic practices and procedures will be acceptable to companies doing business in a particular industry.

We at the Electronic Financial Services Council are participating in promoting the development of these conventions. Over the last seven months, Freddie Mac has developed specifications for purchase of electronically originated loans in the secondary market. Freddie Mac and Fannie Mae are currently negotiating with lenders to arrange forward commitments for the purchase of electronically originated mortgages. As a result, we expect a gradual, but steady growth in paperless mortgage transactions.

Similarly, drawing on the seminal thinking by Freddie Mac in developing its specifications, the Department of Education has promulgated guidelines for the electronic origination of student loans. These loans will be available online next month for students seeking financing for the upcoming academic year.

Our conversations with financial services providers in other industries lead us to believe that similar conventions will develop in these industries as well.

o In addition to the need for time to develop industry guidelines and conventions, another factor slowing the introduction of electronic financial services is the fact that, just as the ESIGN Act became effective, the U.S. economy began to slow and businesses, in an effort to maintain profitability, have reduced capital expenditures, including expenditures on development of electronic channels of communication. Pressures on "dot com" companies and the closure of the "IPO market" have also been factors in slowing adoption of ESIGN technology.

As an attorney advising clients on the implementation of ESIGN, I deal with clients who are wrestling with choices of vendors, decisions regarding authentication, evidence of intent, and authority to sign. Again, ESIGN having become law these companies are now coming to grips with the legal decisions involved in setting up an online contracting process. In absence of court decisions affirming the evidentiary validity of electronic records, those seeking to do business electronically are proceeding with caution.

You have asked whether the consumer consent provisions of the ESIGN Act are hampering the speedy adoption of electronic records. While we recognize that some aspects of the consumer consent provisions may place an unnecessary burden on the use of electronic signatures and records, the Council is firmly committed to the proposition that consumers are entitled to timely and meaningful information concerning their options and all the methods available to them for receiving required notices and disclosures. Electronic commerce cannot reach its full potential without the consumer's complete comfort with, and confidence in, both the process and the medium. Effective delivery of the ESIGN consent disclosures will materially contribute to that comfort and confidence.

The Council strongly supported the original package of consumer protection provisions added to ESIGN in the House of Representatives, the so-called "Inslee-Roukema Amendments." The Council supports the requirement that consumers give affirmative consent to receive electronically information otherwise required to be in writing including disclosure of their rights and responsibilities as participants in electronic transactions.

Certain elements of ESIGN's rules concerning effective consumer consent were not part of the original Inslee-Roukema Amendments. Instead, they were added at the very end of the legislative process and so were, perhaps unavoidably, subjected to a less rigorous level of analysis than the rest of the statute. For example, the Act requires that a consent be in electronic form and that there be a "reasonable demonstration" of the consumer's ability to access the intended information. However, so far these requirements have proven to be hurdles, not barriers, to the use of ESIGN powers.

More specifically, the requirement of electronic consent impairs the use of electronic contracting and disclosure in business models where the relationship begins with a face-to-face meeting in a commercial setting or via telephone (or some combination of the two), but both parties wish to communicate and exchange required information electronically on a going forward basis. Having made the decision to do business electronically, the need to go back and reconfirm the consumer's intent through an electronic channel is burdensome and has led some consumers to abandon the process. The testimony of Fidelity Investments at the April FTC Workshop on ESIGN relating its experience with consumer decisions to do business electronically, pre- and post- ESIGN, is instructive.

Further, the reasonable demonstration test requires interruption of the contracting process to establish, based on a subjective standard, the consumer's ability to access documents. The test also provides an incentive to favor certain file formats over others in order to streamline the testing process. In addition, it should be noted that a technical failure to comply with the ESIGN consent provisions may result in ineffective delivery of required information even if the violation was not intentional and did not prevent receipt and review of the required information. We believe this technical failure may result in disproportionate penalties. These issues are treated in more detail in

the attached copy of the Council's submission to the Federal Trade Commission in connection with its April workshop regarding the benefits and burdens of the consumer consent provisions.

With respect to your question of whether the ESIGN Act and the UETA are operating harmoniously, we have seen no evidence to date that they are not. In this regard, we note that most consumer financial transactions have the federal nexus, and the disclosures mandated by federal law in most cases can only be delivered electronically under the authority granted by the ESIGN Act. Thus, for financial services firms, compliance with the requirements of the ESIGN Act, including consumer consent provisions, is a necessity if they are to provide consumers with electronic financial services.

We do have some concerns, however, regarding implementation of the regulatory requirements contained in Section 104 of the ESIGN Act. We believe that federal and state agencies should adhere to the standards set out in the ESIGN Act when interpreting ESIGN or exempting transactions from its coverage, and we have noticed an early tendency to stray from these standards. Our views on this issue are spelled in more detail in the attached comment letter submitted to the Board of Governors of the Federal Reserve System on the Board's interim final rule on electronic communications.

To sum up, the fact that large-scale implementation of ESIGN has not yet occurred should not be read as a lack of enthusiasm for the statute or a waning of industry interest in electronic commerce. Rather, the deliberate pace reflects the determination of many responsible members of the financial services industry to act thoughtfully and to roll out e-commerce applications that are well designed and well implemented. While some may urge that Congress revisit or amend the ESIGN Act at this point, we believe the best course is to allow the financial service industry and other firms time to acclimate themselves to this new environment and to implement the powers already conferred by the ESIGN Act.

The long term importance of the ESIGN Act for the industries which are under the jurisdiction of your Committee is hard to overstate. Traditional charter and licensing restrictions have limited financial services providers to the products they are entitled to offer at their retail outlets under their respective charters as banks, insurance companies, securities brokers, and so forth. Until now each industry has tended to operate in its separate silo. In the future, it will be possible to mix and match elements of different types of financial products from different providers, perhaps using a web-based advisor or software package. As Marshall MacLuhan observed, "The medium is the message," and for financial services consumers the electronic medium will deliver a message of new financial empowerment, which will in turn, reshape not only the types and varieties of financial products offered to consumers, but may ultimately re-configure the financial services providers themselves.

June 1, 2001

Ms. Jennifer J. Johnson Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Interim Final Rules on Regulation B; Docket No. R-1040
Interim Final Rules on Regulation E; Docket No. R-1041
Interim Final Rules on Regulation M; Docket No. R-1042
Interim Final Rules on Regulation Z; Docket No. R-1043
Interim Final Rules on Regulation DD; Docket No. R-1044

Dear Ms. Johnson:

The Electronic Financial Services Council ("EFSC") is a national trade association which seeks to promote legal and regulatory changes designed to facilitate electronic delivery of financial services. The EFSC appreciates the opportunity to submit its views regarding the interim rules (the "Interim Rule") of the Board of Governors of the Federal Reserve System (the "Board") concerning the use of electronic communications to provide required notices under five consumer protection regulations: B (Equal Credit Opportunity), E (Electronic Fund Transfers), M (Consumer Leasing), Z (Truth in Lending), and DD (Truth in Savings). Although we recognize that there are differences among the interim rules, the EFSC is submitting its comments in this single letter in order to address certain concepts common to all of the proposals. This letter will direct specific comments to the interim rule under Regulation Z.

We strongly support the Board's efforts to facilitate electronic applications and believe that several of the provisions of the Interim Rule could be helpful to both consumers and industry. We are concerned, however, that in promulgating the Interim Rule, the Board has adopted certain interpretations of the meaning of the Electronic Signatures in Global and National Commerce Act (the "ESIGN" or "Act"), Pub. L. No. 106-229, 106th Cong., 2d Sess., 114 Stat. 464 without going through the procedures prescribed under ESIGN, exceeding its authority under the Act. The Board's interpretations, while providing sound practical solutions to important problems, may have the unintended effect of creating future legal uncertainty for financial service providers seeking to make disclosures electronically.

Our most serious concerns are (1) that the Board's Interim Rule in interpreting the word "transaction" in Section 101(c) of ESIGN did not comply with the standards and limitations on rulemaking required by Section 104(b) of ESIGN and (2) that the Board interprets the consumer consent provisions without making the appropriate findings and otherwise complying with the requirements under Section 104 and (3) that the Board misinterprets the timing and delivery exclusion contained in Section 101(c)(2) to permit it to establish differing timing and content requirements for electronic communications than for those provided on paper. If other state or federal agencies adopt similar interpretations of their authority under ESIGN, the Act's effectiveness could be seriously compromised.

The EFSC recognizes that the Board has broad power under TILA to interpret Regulation Z in a way that furthers the goals of the statute. Based on the analysis used to support the Board's 1998 revisions to Regulation E permitting electronic disclosures, it is possible that the Board can support the Interim Rule without reference to ESIGN. However, the EFSC strongly believes that before promulgating a final version of the Rule, the Board should follow the procedures set forth in Section 104 of ESIGN, for three reasons:

o The history and provisions of ESIGN make it clear that Congress intended to provide baseline rules, and regulatory procedures, for replacing writing and signature requirements across the whole range of federal laws and regulations affecting consumer disclosures and notices.

o The use of parallel or alternative authority by the Board will result in a regulatory "double standard", in which federal regulators without the broad interpretive authority of the Board are required to live within ESIGN, while the Board and other regulators with arguably broader authority may avoid its procedures and limitations.

o Since the use of parallel or alternative authority will not supplant ESIGN, institutions wishing to avail themselves of electronic notices and disclosures will be forced to select between two potentially different schemes, creating the potential for both competitive inequalities and confusion for consumers as they encounter widely differing practices.

DISCUSSION

1. The Board Would Interpret Section 101 of ESIGN without Making the Findings Required by Section 104(b).

Our first concern is that the Interim Rule in interpreting the word "transaction" in Section 101(c) of ESIGN does not comply with the standards and limitations on rulemaking required by Section 104(b) of ESIGN.

A. ESIGN's General Rules

E-Sign applies to the use of electronic records and signatures relating to a "transaction in or affecting interstate or foreign commerce." [1] A transaction is defined as any "action or set of actions relating to the conduct of business, consumer, or commercial affairs between two or more persons."[2] E-Sign is a statutory "overlay." It sets up uniform rules revising traditional writing and signature requirements in the law, permitting the use of electronic records and electronic authentication methods instead. Section 101(c) of ESIGN applies a modified rule to any "statute, regulation, or other rule of law [that] [l] *requires* that information relating to a *transaction or transactions* ... [2] be provided or made available to a consumer [3] *in writing*" (emphasis added).

B. Required Findings

As a condition of issuing any regulation, order, or guidance that interprets Section 101 of ESIGN, an agency must satisfy the standards set forth in Section 104(b) of ESIGN, including that:

(A) such regulation, order, or guidance is consistent with section 101; (B) such regulation, order, or guidance does not add to the requirements of such section; and

(C) such agency finds, in connection with the issuance of such regulation, order, or guidance, that-
(i) there is a substantial justification for the regulation, order, or guidance;
(ii) the methods selected to carry out that purpose-
(I) are substantially equivalent to the requirements imposed on records that are not electronic records; and
(II) will not impose unreasonable costs on the acceptance and use of electronic records; and
(iii) the methods selected to carry out that purpose do not require, or accord greater legal status or effect to, the implementation or application of a specific technology or technical specification for performing the functions of creating, storing, generating, receiving, communicating, or authenticating electronic records or electronic signatures.

We also note that the Board can exempt certain types of disclosures under Section 104(d)(1) of ESIGN, which provides that the Board may:

... with respect to matter within its jurisdiction, by regulation or order issued after notice and an opportunity for public comment, exempt without condition a specified category of record or type of record from the requirements relating to consent in section 101(c) if such exemption is necessary to eliminate a substantial burden on electronic commerce and will not increase the material risk of harm to consumers.

C. The Board Used its Interpretive Authority Inappropriately

The Interim Rule authorizes certain disclosures to be provided electronically without first obtaining consumer consent under ESIGN.[3] The disclosures exempted from consent are sometimes referred to collectively as the "shopping disclosures," and include advertisements (§ 226.16 and § 226.24), Home Equity Line of Credit ("HELOC") and Adjustable Rate Mortgage ("ARM") loan application disclosures (§ 226.5b and § 226.19(b)), and disclosures under §§ 226.17(g)(1)-(5) ("Shopping Disclosures"). The exemption is based on a finding by the Board that these disclosures are "deemed not related to a transaction."[4] This is presumably a reference to the provision in Section 101(c) of ESIGN that requires consumer consent to be obtained before presenting "information relating to a transaction" that is otherwise required to be presented in writing.

The result under the Interim Rule makes perfect sense. The consumer has consciously sought out the information in an electronic environment. If the Shopping Disclosures, which are provided before the consumer has entered into any binding obligation, are not delivered in a satisfactory form, the consumer may simply abandon the transaction. Furthermore, interrupting the delivery of these disclosures with ESIGN consent process may create confusion and frustration for the consumer. The consent process may create the impression that a binding commitment to proceed with the transaction is being forced before the Shopping Disclosures are provided, causing the consumer to abandon the process. Ironically, such a result would inhibit, rather than promote, the effective dissemination of the shopping disclosures to potential borrowers.

Unfortunately, however, the approach taken by the Board in implementing the exemption does not appear to conform with either (i) a reasonable interpretation of the term "transaction" as it appears in ESIGN, or (ii) the requirements of Section 104(d) of the Act for exempting disclosures from the consent requirement.

As noted above, the definition of "transaction" in the Act is extremely broad. It covers "any ...set of actions relating to the conduct of. .. consumer ... affairs between two or more persons."[5] Note that the definition does not require that an exchange of value occur, nor that the actions result in a binding agreement. [6] The fact that the borrower has not yet become bound to complete the transaction does not mean that a transaction has not been initiated. By making contact with the lender and seeking out the shopping disclosures, a consumer has begun a process that is related to any loan ultimately made. Even if no loan is made as a result of the disclosures, there has still been a transaction within the meaning of ESIGN; the choice to proceed or not proceed, based on the information provided, is a significant consumer choice that affects both the consumer and the lender. It directly impacts the conduct of the consumer's affairs.

This view of the relevance of pre-obligation communications is consistent with commercial law generally. For example, the express warranties covered by Article 2 of the Uniform Commercial Code include affirmations of fact made by the seller during the advertising and negotiation cycle, well before any commitment is made to purchase or sell. Terms of sale may also include communications made prior to any commitment. All of these communications are viewed as related to the final transaction, because they form part of the foundation for the mutual understanding of the parties. The shopping disclosures fulfill the same function.

Even though the result reached by the Board is both reasonable and desirable, the reasoning used to support it is of grave concern. A narrowing of the term "transaction"

as defined in ESIGN constitutes an invitation to other regulators to conclude that various consumer disclosures within their jurisdiction are not "related to a transaction," and so are not covered by ESIGN at all, permitting the reintroduction of paper requirements that otherwise would be prohibited under ESIGN.

As an alternative to attempting to narrow the statutory definition of "transaction" the Board has the option of making an explicit decision to exempt the shopping disclosures from ESIGN's consent requirement. Applying the consent process to the Shopping Disclosures, which were deliberately sought out by the consumer in an electronic environment, is both burdensome and largely pointless. Because the consumer has no obligation to proceed, if the disclosures are not effectively delivered or cannot be read, the consumer may simply abandon the transaction, so that no material harm will result from the lack of consent.

By narrowing the scope of the definition of transaction in reaching its conclusion, the Board interprets Section 101(c) of ESIGN as not applying to certain disclosures. In such cases, the Board must satisfy the requirements of Section 104(b) of ESIGN before reaching a conclusion about the applicability of Section 101 of ESIGN to these disclosures. On the other hand, the Board could have exempted such categories of disclosures from Section 101(c) of ESIGN by following the procedures set forth in Section 104(d)(1). Given the burdens that the consumer consent provisions impose on shopping disclosures, the Board could have used either its interpretive or exceptive authority under the Act to eliminate such burdens without taking the extraordinary step of excluding shopping activities from the definition of a transaction under Section 101(c).

The Board fails to reconcile its conclusion that shopping is not related to a transaction for purposes of Section 101 (c) with its apparent intent to include such activities within the scope of the definition of transaction in Section 106. Our concern with this line of reasoning is that it opens the door to excluding certain commercial activities such as shopping from the definition of transaction under both Sections 101 (c) and 106, thus denying such activities both the burdens and the benefits of ESIGN. Such a line of reasoning in the hands of a regulator not favorably disposed to electronic commerce might consign shopping disclosures to a paper environment only. Clearly Congress did not intend such a result when it established detailed procedures for exercise by a regulator of its interpretive and exemptive authority under ESIGN.

II. Any Regulation Must be Consistent with the Broad Purposes of ESIGN.

A. Interpretation of the Consumer Consent Provisions

The Board interprets the consumer consent provisions without making the appropriate findings and otherwise complying with the requirements under Section 104. As noted above, in order to interpret the consumer consent provisions, the Board must find among other things, that there is a substantial justification for the Board's action, the resulting requirements for electronic disclosures will be substantially similar to the requirements for paper disclosures, and the requirements for electronic disclosures will not impose unreasonable cost.

We believe that the Interim Rule imposes delivery-related requirements on electronic disclosures that (i) add to the requirements of Section 101, and (ii) are not substantially equivalent to the requirements for equivalent writings. In addition, to the extent these requirements do not otherwise violate ESIGN, the Board has still failed make specific findings that (i) the regulation is substantially justified, (ii) the methods used to implement it are substantially equivalent to those for non-electronic records and will not impose unreasonable costs, and (iii) the methods are technology-neutral. [7]

E-mail notice for disclosures displayed in real time

The Interim Rule provides that, for disclosures other than the Shopping Disclosures, if a disclosure is posted on a website the consumer must be sent an e-mail (or postal mail) informing the consumer of the location at which the disclosure is available for review. The disclosure must remain available for at least ninety days from the delivery date. The requirement to deliver an e-mail (or postal) notification appears to apply even if the disclosure is being displayed and viewed at the website as part of an interactive real time session with the consumer. Under ESIGN, an electronic disclosure is the operative disclosure. In the case where a disclosure or notice is being reviewed on a website in real time, that disclosure is effective when it is displayed, just as it would be effective when handed across a desk or delivered in the mail. If the consumer is offered the opportunity to retain a copy by printing or download at the time of display, then the record retention rules of ESIGN have been satisfied.[8] Requiring additional notification constitutes a burden that is not equivalent to any imposed for paper documents. The Interim Rule should be revised to clarify that the e-mail notice is not required when the disclosure or notice is being displayed to the consumer electronically in real time as part of an interactive session.[9]

Redelivery

The Interim Rule requires a creditor to take "reasonable steps" to attempt redelivery of an electronic communication if the disclosure is returned undelivered. The Commentary indicates that such steps must include sending the disclosure to a different e-mail or postal address that the creditor has "on file." No such requirement is imposed when disclosures are initially made through postal mail.

The redelivery issue is an example of an area in which the Board might be permitted to issue regulatory interpretations under ESIGN if it could make the required findings, including a determination that the methods chosen in the regulation are "substantially equivalent" to those that apply to non-electronic records and that they "will not impose unreasonable costs." Due to the limitations of current technology, it may be more likely that e-mail will be returned as undeliverable than that a postal letter will be, which could provide a basis for regulatory action. But the method that the Board has chosen-requiring the creditor to send a second notice to another address that the creditor has "on file"-has the potential to be burdensome, because the creditor may have other addresses for the applicant "on file" but have no way to connect those addresses with the applicant.

B. Interpretation of the Timing and Content Exclusion

The Board misinterprets the timing exclusion contained in Section 101(c)(2) to permit it to establish different timing requirements for electronic communications than for those provided on paper.

Section 101(c)(2) of ESIGN states that-

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.

Although the Board's rulemaking authority gives it power to issue regulations effecting content and timing, ESIGN overrides any other statute, regulation, or rule of law that may be inconsistent with ESIGN. As the Board acknowledges in the Preamble, regulatory agencies have limited authority to interpret ESIGN. The Act gives the Board no power to undermine the safe harbor that the Act creates.[10] Thus, any regulations issued by the Board must be consistent with the broad purpose of ESIGN.[11] Regulation effecting electronic disclosures that exceed those for written ones should not be issued until the Section 104(b) findings are made to ensure that the intent of Congress and the purpose of ESIGN are upheld.

By purporting to impose requirements beyond those in ESIGN, the Board's Interim Rule undermines ESIGN's fundamental purpose. If the Board's Interim Rule is allowed to stand, then the intent of Congress-"to facilitate e-commerce and to provide legal certainty for electronic signatures, contracts and records where such certainty [did] not exist"[12]-will be defeated.

C. Delivery of Forced Disclosures using Multiple Screens"

The Board's interpretation of §226.36(b) includes the following analysis of methods for forcing the review of certain disclosures:

When a creditor permits the consumer to consummate a closed-end transaction on-line, the consumer must be required to access the disclosures required under § 226.18 before becoming obligated. A link to the disclosures satisfies the timing rule if the consumer cannot bypass the disclosures before becoming obligated. Or the disclosures in this example must automatically appear on the screen, even if multiple screens are required to view the entire disclosure.

The methods for forcing disclosure described in the Staff Interpretation are instructive. However, it is not clear from the Staff's comments whether the methods described are intended to be examples, or to constitute the exclusive methods for deploying a forced disclosure. In particular, the reference to "multiple screens" could be read as a rejection of the use of scroll boxes to deliver disclosures that require more than a single screen for full display. Prohibiting the use of scroll boxes for the delivery of important information would be contrary to both current practice and would set a different standard than the guidelines for conspicuous disclosure provided by the FTC in connection with the delivery of online privacy notices, which permit the use of scroll boxes for delivering disclosures.[13] The Board should consider revising the Staff Interpretation to reflect that there are a broader range of delivery solutions available, beyond the examples provided in the Interpretation.

CONCLUSION

The EFSC strongly supports the Board's actions in formulating and promulgating the Interim Rule. The Interim Rule provides valuable guidance on the delivery of electronic disclosures and notices. It is at least arguable that the Board has the authority to issue the Interim Rule without regard to the requirements of ESIGN. However,

the law of electronic records and signatures is in its infancy. ESIGN creates a new environment for delivering notices and disclosures. It is intended to foster both efficiency and innovation. Congress clearly intended ESIGN to provide an across-the-board set of guidelines for federal regulation of electronic notices and disclosures used in place of required writings. The Board is a highly influential and well-regarded regulator, and the Interim Rule represents the first comprehensive attempt to interpret ESIGN as it applies to specific federal disclosure requirements. The EFSC believes it is essential that the Board's final Rule complies with the procedural requirements and limitations of ESIGN, in order to promote a uniform environment for electronic transactions and clear early guidance to other regulators addressing the same issues. The EFSC looks forward to working the Board Staff to achieve these goals.
The EFSC appreciates the opportunity to comment on the Interim Rule.

Very truly yours, [SIGNED] Jeremiah S. Buckley

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[1] ESIGN § 101(a).
[2] ESIGN § 106.
[3] Interim Rule §226.36(c).
[4] Interim Rule §226.36(c).
[5] ESIGN § 106(13).
[6] Although the language of the statute is clear, it is also supported by the legislative history of the E-Sign Act. As shown in the following colloquy from the Senate floor debate on the bill, in enacting the E-Sign Act, Congress intended to establish broad application of the Act:

"MR. GRAMM. As to its coverage, does the Senator agree that *this act is intended to operate very broadly to permit the use of electronic signatures and electronic records in all business, consumer and commercial contexts? This breadth is accomplished through the use of the term 'transaction,' which is defined broadly* to include any action or set of actions by one of the parties to the underlying transaction, or by any other person with any interest n the underlying transaction, or a response by one party to the other's action, all are covered by the act. In this regard, it is the nature of the activity, rather than the number of persons or the identity or status of the person or entity involved in the activity, that determines the applicability of the act. Have I stated the matter correctly?
"MR. ABRAHAM. Yes, this act applies to all actions or set of actions related to the underlying business, consumer, or commercial relationship which is based on the nature of the activity and not the number of persons involved in the activity. The act is also intended to cover the related activities of those persons or entities who are counterparties to, or otherwise involved in or related to, the covered activity."

[7] See ESIGN § 104(b).
[8] See ESIGN § 101(e).
[9] For disclosures that are not made in real time (other than Shopping Disclosures), the Interim Rule requires that those disclosures either be (i) delivered to an e-mail address or (ii) made available at another location (such as an Internet website) with an accompanying notification of availability delivered to an e-mail address or a postal address. It is the experience of the EFSC's members that a certain small percentage of those consumers moving past the "shopping" phase of a transaction do not have, or are not willing to provide, an electronic address. The use of a postal address as a substitute for notification effectively eliminates any efficiencies derived from electronic disclosures. If those consumers unable or unwilling to provide an electronic address have agreed to receive electronic disclosures and have not withdrawn their consent, then it seems reasonable that other alternatives should be available for delivering disclosures. For example, the approximate timetable for delivery of specified disclosures, and the location at which they will be posted, could be provided to the consumer at the time of application if an e-mail address is not available. The Board may wish to consider offering such consumers the opportunity to participate in e-commerce by authorizing alternatives to e-mail notice, including the provision of a timetable and location for disclosures as an alternative for consenting consumers who have not provided an e-mail address.

[10] This notion is clearly documented in the legislative history of ESIGN:
The conference report is designed to prevent Federal and State Regulators from undermining the broad purpose of this Act, to facilitate electronic commerce and electronic record keeping. *To ensure that the purposes of the Act are upheld, Federal and State regulatory authority is strictly circumscribed.* It is expected that Courts reviewing administrative actions will be rigorous in seeing that the purpose of this Act, to ensure the widest use and dissemination of electronic commerce and records are not undermined. [Cite to Congressional Record - House H4355 (emphasis added).]

[11] The legislative history of the ESIGN is again helpful:
As the bill makes clear, each agency will be proceeding under its preexisting rulemaking authority, so that the regulations or guidance interpreting section 101 will be

entitled to the same deference that the agency's interpretations would usually receive. *This is underlined by the bill's requirements that regulations be consistent with section 101*, and not add requirements of that section, which restate the usual Chevron test that applies to and limits an agency's interpretation of a law it administers. [Cite to Congressional Record-House H4358-9 (emphasis added (sic))].

[12] 146 Cong. Rec. S5282 (June 16, 2000) (emphasis added).
[13] See 16 CFR Part 313.

April 18, 2001

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Re: ESIGN Study - Comment P004102 -- Additional comments

To the Federal Trade Commission ("FTC"):

This letter is provided in response to your invitation to provide additional comments following the FTC Public Workshop on the Electronic Signatures in Global and National Commerce Act ("ESIGN") on April 3, 2001. The Electronic Financial Services Council ("EFSC") was pleased to participate in the Workshop. The views expressed by the participants, and the information shared, offered useful Insight into the ESIGN consumer consent rules and the challenges they present.

The EFSC would like to highlight two important points that were made during the Workshop concerning the Section 101(c)(1)(C)(ii) requirements (the "electronic consent requirement"):

o Empirical evidence presented at the Workshop, particularly the information supplied by Paul Gallagher of Fidelity, suggests that the electronic consent requirement is creating a barrier to adoption of electronic communications by consumers who are willing and able to do so; and

o The principal rationale for the electronic consent requirement may be based on a faulty premise.

The Electronic Consent Requirement As A Barrier To E-Commerce

At the Workshop, Fidelity Investments shared its experience with the impact of the electronic consent requirement on consumer adoption of electronic communication. Prior to ESIGN, Fidelity had been obtaining In-person agreement from new customers willing to receive electronic delivery of information. Many of Fidelity's customers opted for electronic delivery and used It successfully. Since beginning ESIGN compliance, Fidelity now requires electronic confirmation and a "reasonable demonstration" test as part of the consent process. As a result, the percentage of new customers who complete the consent process and use electronic delivery has fallen off measurably. The only apparent explanation is that the additional steps required by ESIGN serve as an unintentional deterrent to giving consent.

The securities industry is the industry where, because of SEC initiatives, there was the most use of electronic media to complete financial transactions. As such, it provides a valuable testing ground for the impact of the two requirements mentioned above. Because Fidelity is among the larger players in the electronic delivery of securities services, its testimony should be given great weight by the FTC and the Commerce Department. Given the fact that other industries will not have the "contror" of pre- and

post-ESign experience, this may be the most valuable data in evaluating the impact of the requirements on which the Workshop focused, and as such is more valuable than speculation about what consumers expect or need. So far as we are aware there were no complaints about fraud or deception related to companies operating under the old SEC rules.

The Electronic Consent Requirement May Be Based On A Faulty Premise

Workshop participants supporting the electronic consent requirement suggested that its primary purpose is to prevent the abuse of electronic disclosures: a seller or service provider otherwise dealing in paper documents as part of an in-person transaction might obtain consent on paper for the purpose of diverting disclosures to an electronic environment in the hope that the disclosures would either be inaccessible or not accessible on a timely basis, or that the consumer would not bother to review them. Participants suggested that, absent the electronic consent requirement, ESIGN would validate these practices. As the EFSC pointed out, a variety of existing laws protect consumers against such behavior.

An attempt to obtain paper consent and use electronic disclosures for fraudulent purposes would run afoul of state and federal laws on deceptive trade practices, as well as disclosure timing and delivery rules. Absent a valid, articulated business purpose, the fact that a face-to-face transaction was otherwise being documented on paper while important disclosures were being delivered electronically could, in and of itself, serve as an indication of fraudulent intent. The electronic consent requirement appears to take aim at practices for which other, better-targeted protections exist.

Any legitimate firm has a strong motivation to assure that the electronic method of communication adopted by the firm and its customer works for both. It Is the intention that this electronic channel of communication will be used not simply for delivery of disclosures, but will serve as the means of ongoing communication with customers such as sending periodic statements, reminder notices, updated agreements or additions to agreements, tax-related information, and even solicitations for new and improved products and services.

While the EFSC continues to believe that it is premature for Congress to amend ESign, we strongly urge that your report to Congress reflect the fact that initial indications are that the provisions cited are having an negative impact on usage of ESign and that the anti-fraud purposes for which they are designed may be more appropriately addressed by other means.

Thanks again for the opportunity to participate 1n the Workshop. If you have any questions, or would like any additional information, please do not hesitate to contact the EFSC at the address and telephone number above.

Sincerely,

Jeremiah S. Buckley
General Counsel