CFPB’s “One Size Fits All” Regulation May Limit Transfer Services Offered by Depository Institutions

By: Chris Driskill

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Synopsis.

On January 20, 2012, the Consumer Financial Protection Bureau (“CFPB”) issued its first regulation, which imposes certain disclosure and error-resolution requirements on providers of “international remittance transfers.” Instead of limiting the regulation’s coverage to traditional “remittance transfers”—defined by the World Bank as “cross-border person-to-person payments of relatively low value”—the CFPB’s Final Rule applies broadly to any transaction in which a consumer sends money overseas, including wire transfers, Automated Clearing House (ACH) transactions, and online bill payments. Complying with the Final Rule will be costly and difficult for depository institutions that offer international transfer services such as wire transfers. Larger depository institutions may have to significantly increase the costs of any transfer services they offer, and community banks and credit unions may have to stop providing international transfer services altogether.

For community banks and credit unions that are not subject to the CFPB’s direct supervision, and for depository institutions that may have thought they did not provide “remittance transfers,” the Final Rule should serve as a wake-up call. In its attempt to protect what should have been a very limited class of consumer transactions, the CFPB has issued a regulation that will have profound effects on the entire financial services industry. If its first regulation is an indication of things to come, every financial institution, regardless of size or services provided, should pay close attention to the actions of the CFPB.

“Closed” vs. “Open” Network Remittance Transfers.

Remittance transfers are generally made in one of two ways. In a “closed-network” transfer, the institution that receives the transferred funds is either owned by, or the agent of, the sending institution. Under closed-network systems the sending institution can control a transfer end-to-end. Closed-network systems are generally utilized by non-depository “money transmitters” such as Western Union and MoneyGram, and transfers made via closed-network systems are usually for lower dollar amounts sent to natural persons.

In an “open-network” transfer the recipient institution is unaffiliated with the sending institution. Also, open-network transfers often pass through intermediary institutions on their way from the transfer provider to the recipient institution. International transfer services provided by depository institutions—such as wire transfers—are generally made through open-networks. These open-network transactions are often made for larger amounts than...
traditional “remittance transfers,” and are frequently sent to businesses rather than natural persons.4

**Remittance Transfers under the Final Rule.**

The CFPB issued the Final Rule pursuant to Section 1073 of the Dodd-Frank Act, which mandated that the CFPB expand the regulatory scope of Regulation E to cover international remittance transfers. As stated in the Senate Report covering Dodd-Frank, the purpose of Section 1073 was to provide regulatory protections to immigrants who “send substantial portions of their earnings to family members abroad”—i.e., traditional, closed-network transfers sent to natural persons. In comments to the proposed rule, industry advocates urged the CFPB to limit the coverage of the Final Rule to traditional remittance transfers by either excluding open-network transfers from the Rule entirely, or by limiting the Rule’s coverage to transfers sent to natural persons for small dollar amounts. Given the opportunity to write a nuanced rule that would protect the consumers contemplated by Dodd-Frank without overburdening financial institutions, the CFPB declined.

Instead, the Final Rule defines “remittance transfer” broadly as “the electronic transfer of funds requested by a sender to a designated recipient that is sent by a remittance transfer provider.”6 Under the Final Rule a “designated recipient” can be either a natural person or a business, and a “remittance transfer provider” is any institution that provides international transfers “in the normal course of its business.” While the Final Rule does not contain a precise definition for “normal course of business,” the CFPB has issued a concurrent proposed rule that would set the threshold for application of the Final Rule at twenty-five (25) transfers per year, a number that would exclude few, if any, depository institutions from coverage under the Final Rule.7

Accordingly, the new regulation will cover virtually every situation in which a consumer sends funds overseas, including wire transfers, online bill payments, ACH transfers, recurring automatic transfers, and transfers made via pre-paid cards. The litmus test for application of the Final Rule is whether the funds are transferred to an account that is located outside of the United States.8 The Final Rule does contain two narrow exclusions, one exempting transactions less than $15, and another excluding transactions made for the purchase of securities or commodities regulated by the SEC.9

**Disclosure Requirements.**10

Under the Final Rule any financial institution that initiates an international consumer transfer will be required to provide a written, pre-payment disclosure that states:

- The exact amount that will be transferred to the recipient in both the currency in which the transfer is funded and the currency in which the transfer is distributed to the recipient
- Any fees imposed on the transaction by either the provider itself or any other person or entity
- Any taxes imposed by either the state in which the transfer is initiated or the recipient’s country
- The exchange rate applied to the transaction
- The date on which the funds will be available to the recipient; and
- A description of the provider’s cancellation and error resolution procedures.

The date on which the funds will become available and the provider’s error-resolution procedures can alternatively be provided on a post-transaction receipt. For transfers that are initiated by phone or text message, a transfer provider may make the required disclosures orally or via text.

**Mandated Error Resolution Procedures.**

The Final Rule defines “error” as “(i) An incorrect amount paid by a sender in connection with a remittance transfer; (ii) A computational or bookkeeping error made by the remittance transfer provider relating to a remittance transfer; [or] (iii) the failure to make available to a designated recipient the amount of currency stated in the disclosure provided to the sender.” The Rule requires transfer providers to investigate any errors reported by transfer senders within 90 days of receiving a notice from the sender. The transfer provider must provide a written report detailing the results of its investigation to the sender within three business days of its completing its investigation. If the sender determines that an error has occurred, it must provide the correct amount of funds to either the sender or the recipient, free of charge.

**Temporary Exception for Insured Institutions.**

In a purported effort to ease the burden on open-network transfer providers, the Final Rule provides a temporary exception that permits insured depository institutions and credit unions to estimate the exchange rate used and fees imposed by other entities for certain open-network transactions. The temporary exception applies where an insured institution does not have a “correspondent relationship” with the recipient institution. The rule does not define “correspondent relationship,” but states in its supplementary information that a “correspondent relationship is generally one in which a financial institution has a contractual arrangement to hold deposits and provide services to another financial institution.” While on its face the temporary exception would seem to significantly ease the burden of compliance for open-network providers, in reality the estimation processes contemplated by the Final Rule are unworkable. Moreover, the temporary exception will expire on July 21, 2015, at which point all institutions will be required to comply with the exact disclosure requirements under the Final Rule.

**Compliance Issues for Providers of Open-Network Transfers.**

Compliance with the final rule will be difficult, if not impossible, for providers of open-network transfers. While the CFPB noted that “Implementation is likely to be most challenging for depository institutions and credit unions that engage in open network wire transactions,” and
that “the final rule may also expose depository institutions and credit unions to new types of risk,” it refused to enact adequate protections for those institutions. Specific compliance difficulties include:

**Exchange rates.**

Requiring an institution to provide a pre-payment disclosure listing the exact exchange rate that will apply to the transaction ignores the operational realities of open-network transfers. Most depository institutions, and particularly smaller institutions such as community banks and credit unions, do not perform currency conversions themselves. Instead, these institutions rely on intermediary or recipient institutions to perform the conversion, and frequently contract for exchange rates in real time, so as to provide their customers with the most competitive exchange rate available. Intermediate and recipient institutions generally do not provide the sending institution with the exchange rate used until after the transaction is completed, and frequently do not disclose the exchange rate at all. This is often true even where the provider has a “correspondent relationship” with the intermediary or recipient institution. Therefore, compliance with the final rule will require depository institutions to re-write their contracts with intermediary and recipient institutions so as to require pre-payment disclosures of exchange rates, and will eliminate altogether the ability to contract for exchange rates in real time. Transfer providers will then have to maintain a continually updated database of the exchange rates currently used by any intermediary or recipient institutions with which they have a correspondent relationship.

Even where the sender does not have a “correspondent relationship” with the intermediary or recipient institutions, the estimate procedures permitted under the temporary exception to the Final Rule will place a heavy burden on open-network transfer providers. The Final Rule provides two bases for estimating exchange rates. A remittance transfer provider may estimate the exchange rate based on (1) the most recently available publicly available wholesale exchange rate, combined with the “spread” typically applied to remittance transfers for a particular currency, or (2) the most recent exchange rate offered or used by the institution in the transmittal route that is setting the exchange rate for the transaction. According to the Final Rule, providers that do not have correspondent relationships with intermediary or recipient institutions will still have to maintain a continually updated database of current wholesale exchange rates and “typical spreads” for particular currencies, or, alternatively, a database of the most recent exchange rates used by any intermediary or recipient institution that might be involved in a particular transaction.

**Fees imposed by other institutions.**

The requirement that a remittance transfer provider disclose all fees that might be imposed by other institutions also imposes heavy burdens on open-network transfer providers. The fees imposed by recipient institutions are typically determined by contracts between the recipient institution and its customer, and are seldom, if ever, disclosed to the sending institution. Again, to meet the requirements under the Final Rule, providers of open-network transfers will have to re-negotiate their contracts with intermediary and recipient institutions and maintain an updated database of all fees imposed by those institutions.
The estimation process for other fees under the temporary exception is similarly unworkable. The Final Rule again provides for two permissible estimation processes. A transfer provider may estimate fees based on (1) the fees imposed on the provider’s most recent transfer to an account at the designated recipient’s institution, or (2) representations from intermediary and recipient institutions of all fees likely to be imposed. Therefore, even under the exception, providers of open-network transfers will have to maintain a database of fees applied by any institution that they have previously sent funds to, and/or obtain estimates of fees that will likely be imposed by each institution on a transfer route before the transfer is sent.

Foreign taxes.

The Final Rule requires a remittance transfer provider to disclose any foreign taxes that will be applied to a remittance transfer. This will require all remittance transfer providers to continually monitor foreign tax laws, and to update their disclosure systems any time those laws are amended. This requirement will impose substantial burdens on all institutions that offer international transfer services, but particularly on smaller institutions that do not have the resources to continually monitor foreign tax laws.

Error Resolution.

If there is an error in any part of the transfer process, the Final Rule requires the sending institution to provide the ultimate recipient with the correct amount of the transfer, free of charge, and to refund any incorrectly stated fees or taxes. Accordingly, institutions that utilize open-networks could be subjected to additional fees from intermediate or recipient institutions when sending corrected transfers, and may be forced to refund fees or taxes that have already been received by other entities, and that cannot easily be recouped. Additionally, the Final Rule requires a sending institution to investigate and remedy any errors in the disclosure, including where the designated recipient failed to receive the exact amount stated in the pre-transfer disclosure or the funds were not available on the date specified in the disclosure. Because of the nature of open-network transactions, the error-resolution requirements under the Final Rule will require sending institutions to investigate—and remedy—errors caused entirely by intermediary or recipient institutions that they do not control.

Displacement of UCC Article 4A. The Final Rule creates additional difficulties for providers of wire transfers because it removes any transactions covered by the Final Rule from the purview of Uniform Commercial Code (”UCC”) Article 4A. Article 4A, which allocates risks among financial institutions for wire transfers, has informed banking industry standards and practices regarding wire transfers for over thirty years. Because every state’s version of the UCC excludes any transaction that is covered by the EFTA, the Final Rule will render Article 4A inapplicable to international wire transfers initiated by consumers.

Commenters, including the Office of the Comptroller of the Currency, noted that the proposed rule’s complete displacement of UCC Article 4A will create legal uncertainty as to the rights and responsibilities of institutions that send wire transfers for consumers.
Commenters urged the CFPB to either preempt the UCC’s EFTA exclusion as applied to transactions covered by the Final Rule, or to incorporate the risk allocation procedures from Article 4A into the Final Rule. The CFPB again declined, and instead suggested that each State amend its Article 4A to lift the exemption for consumer wire transfers covered by the Final Rule. Until such time as each state adopts such an amendment financial institutions will face unknown risks and liabilities when providing consumer wire transfers, and will be unable to adjust their policies and procedures accordingly.

**Conclusion.**

Compliance with the final rule will be difficult, if not impossible, for institutions that provide open-network international transfers. Depository institutions that wish to offer wire transfer services to consumers will have to create and maintain databases that continually monitor international taxes, as well as fees and exchange rates used by institutions that they do not control. In its commentary to the Final Rule, the CFPB estimated that it will take depository institutions 200 business hours to develop initial compliance systems, and an ongoing investment of 9.5 hours per month and 16 additional hours annually to update and maintain disclosure and error-resolution procedures. Industry commenters have noted these estimates may grossly underestimate the actual burden imposed on providers or open-network transfers. The CFPB has noted that all 7,445 depository institutions insured by the FDIC and approximately one-half (3,193) of all credit unions offer wire transfer services that are covered by the Final Rule. Once these institutions accurately assess the cost of compliance with the Final Rule, that number may decrease significantly.

**ABOUT THE AUTHOR:**

Chris Driskill is an associate in Waller’s Birmingham office in the firm’s Trial and Appellate Litigation practice. He focuses on serving financial services companies and other clients facing complex commercial and civil litigation. Chris earned his J.D., *magna cum laude*, from the University of Alabama and a B.S. in business administration from the University of Tennessee.

Chris can be reached at 205.226.5705 | chris.driskill@wallerlaw.com

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specific legal guidance.

1 The full text of the regulation, which is codified at 12 C.F.R. Part 1005, et seq., is available at https://www.federalregister.gov/articles/2012/02/07/2012-1728/electronic-fund-transfers-regulation-e.


4 See id.


6 The statutory definitions are contained in 12 C.F.R. Part 1005.31.

7 See Concurrent Proposed Rule, available at https://www.federalregister.gov/articles/2012/02/07/2012-1726/electronic-fund-transfers-regulation-e. While the CFPB has requested commentary on the propriety of raising the 25 transaction threshold, given the starting point it is unlikely that any final threshold will have a meaningful impact on depository institutions. In commentary to the proposed rule, industry groups representing community banks and credit unions suggested an exemption threshold between 1,200 and 2,400 transfers per year. See Commentary to Final Rule.

8 See Final Comment 30(c)-2.ii.

9 See 12 C.F.R. Part 1005.30(e)(2)(i) and Part 1005.3(c)(4), respectively.

10 The disclosure requirements are contained in 12 C.F.R Part 1005.31.

11 The error resolution procedures are outlined in 12 C.F.R. Part 1005.33.

12 The temporary exceptions are contained in 12 C.F.R. Part 1005.32.

13 The CFPB has the option to extend the temporary exception for an additional five years. The Final Rule also contains a permanent exception which allows providers to estimate figures where the laws of a foreign country prevent compliance with the Final Rule. See 12 C.F.R. Part 1005.32(b).

14 See 12 C.F.R. Part 1005.32(c).