

# MAKING PAYPAL PAY: REGULATION E AND ITS APPLICATION TO ALTERNATIVE PAYMENT SERVICES

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## ABSTRACT

*In light of the growth of data breaches in both occurrence and scale, it is more important than ever for consumers to be aware of the protections afforded to them under the law regarding electronic fund transfers and alternative payment services. Additionally, it is important that agencies like the Consumer Financial Protection Bureau (“CFPB”), charged with the protection of unsuspecting and often defenseless consumers, are carefully monitoring these protections to ensure they keep pace with the technological evolution of the payment services they regulate. Alternative payment services, such as PayPal, are conducting an enormous number of payments and providing an extremely beneficial service in the era of e-commerce.*

*This Issue Brief argues that, as currently written, the Electronic Fund Transfer Act, implemented by Regulation E, does not adequately protect consumers using these alternative payment services. Regulation E is insufficiently specific and provides circular language in its key definitions, including those for the terms “financial institution” and “account.” These deficiencies could leave consumers engaged with alternative payment services in the unique position of facing unlimited liability for losses resulting from unauthorized electronic fund transfers from their alternative payment service account. Thus, this Issue Brief argues that in order to ensure that Regulation E is written broadly enough to apply to all the functions of PayPal, the CFPB should clarify its language.*

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## INTRODUCTION

On December 18th, 2013, just one week before Christmas, independent cyber security expert Brian Krebs announced that Target Corporation, one of America's largest retailers,<sup>1</sup> was investigating a data breach involving millions of its customers' debit and credit cards.<sup>2</sup> The following day, Target confirmed that approximately 40 million debit and credit cards used at various Target locations nationwide were affected by cyber theft.<sup>3</sup> The incident was the second largest debit- or credit-related theft in U.S. history. For the first time, many Americans' attention<sup>4</sup> was drawn to one of the realities of banking in the 21st Century: the vulnerability of electronic payment data to cyber theft.<sup>5</sup> Just a few months later (in May 2014), eBay Corporation was the victim of an even larger data breach resulting in the loss of 145 million usernames and passwords.<sup>6</sup> This data breach left many people asking: if eBay was breached, was its wholly

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<sup>1</sup> See *Target Corporation*, FORTUNE, [http://fortune.com/fortune500/2013/target-corporation-36/?iid=F500\\_sp\\_full](http://fortune.com/fortune500/2013/target-corporation-36/?iid=F500_sp_full) (last visited Mar. 10, 2015) (describing Target as the second-largest retailer in the United States).

<sup>2</sup> See Brian Krebs, *Sources: Target Investigating Data Breach*, KREBSONSECURITY (Dec. 19, 2014, 8:20 AM), <http://krebsonsecurity.com/2013/12/sources-target-investigating-data-breach/>.

<sup>3</sup> Press Release, Target Corporation, Target Confirms Unauthorized Access to Payment Card Data in U.S. Stores (Dec. 19, 2013), available at <http://pressroom.target.com/news/target-confirms-unauthorized-access-to-payment-card-data-in-u-s-stores>. Three weeks later, Target reported that an additional 70 million customers may have had their names, mailing addresses, phone numbers and email address stolen in the breach. Press Release, Target Corporation, An Update on Our Data Breach and Financial Performance (Jan. 10, 2014), available at <https://corporate.target.com/discover/article/an-update-on-our-data-breach-and-financial-perform>. However, this type of theft is beyond the scope of this Issue Brief.

<sup>4</sup> Likely because the proximity to Christmas and the name brand recognition of Target. See, e.g., Anne D'Innocenzio & Bree Fowler, *Fury and frustration over Target data breach*, USA TODAY (Dec. 20, 2013), <http://www.usatoday.com/story/money/business/2013/12/20/fury-and-frustration-over-target-data-breach/4145503/> (suggesting that customers may be more likely to use a competitor); Patrik Jonsson, *So a cyber Grinch stole your card at Target? Here's what to do.*, CHRISTIAN SCI. MONITOR (Dec. 19, 2013), <http://www.csmonitor.com/USA/2013/1219/So-a-cyber-Grinch-stole-your-card-at-Target-Here-s-what-to-do.-video> (noting the timing of the breach).

<sup>5</sup> Second only to the theft of 45 million debit and credit card accounts from the parent company of retailer TJ Maxx in January, 2007. Andria Cheng, *Target admits 40 million cards are compromised; TJX's 2007 breach cost \$256 million*, MARKET WATCH (Dec. 19, 2013, 10:58 AM), <http://blogs.marketwatch.com/behindthestorefront/2013/12/19/targets-card-breach-delivers-a-rude-christmas-surprise/>.

<sup>6</sup> Niall McCarthy, *Chart: The Biggest Data Breaches in U.S. History*, FORBES (Aug. 26, 2014, 8:17 AM), <http://www.forbes.com/sites/niallmccarthy/2014/08/26/chart-the-biggest-data-breaches-in-u-s-history/>.

owned subsidiary PayPal affected?<sup>7</sup> Despite eBay's insistence that PayPal accounts were not compromised, experts worry that many eBay users rely on the same usernames and passwords for both services, thus making eBay's lack of concern appear disingenuous.<sup>8</sup>

Despite anxiety from the idea that their banking information may have fallen into the wrong hands, however, most Americans have little to fear with respect to the Target and eBay data breaches.<sup>9</sup> Electronic fund transfers ("EFTs"), such as those associated with the use of debit or credit cards issued by financial institutions, have long been protected by the Electronic Fund Transfer Act ("EFTA").<sup>10</sup> The EFTA, which is implemented by Regulation E ("Reg. E")<sup>11</sup> and enforced by the Consumer Financial Protection Bureau ("CFPB"),<sup>12</sup> establishes the basic rights, liabilities, and responsibilities of consumers who use EFTs.<sup>13</sup> Its primary objective is consumer protection.<sup>14</sup> In most cases, Reg. E limits a consumer's liability for unauthorized EFTs, such as those arising from loss or theft of a debit or credit card, to \$50.<sup>15</sup> Thus, most of the victims of the Target data breaches are at risk of losing only a nominal amount due to the exposure.<sup>16</sup>

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<sup>7</sup> Brian R. Fitzgerald, *If eBay Was Breached, What About PayPal?*, WALL ST. J. (May 21, 2014, 1:38 PM), <http://blogs.wsj.com/digits/2014/05/21/if-ebay-was-breached-what-about-paypal/>.

<sup>8</sup> *Id.*

<sup>9</sup> *I.e.*, for reasons that this brief explains, see *infra* text accompanying notes 85–107, so long as consumers closely adhere to the requirements of Reg. E, there is little to be feared relating specifically to unauthorized debit or credit card use. However, it should be noted that the theft of personal information including names, mailing addresses, phones numbers and email addresses carry very serious financial and other risks.

<sup>10</sup> See generally 15 U.S.C. §§ 1693–1693r (2012) (providing consumer protections for losses relating to EFTs since 1978).

<sup>11</sup> Regulation E, 12 C.F.R. §§ 1005.1–1005.36 (2013).

<sup>12</sup> See 15 U.S.C. § 1693b(a)(1) (2012) (discussing the role of the CFPB in electronic fund transfer regulation); *About Us*, CFPB, <http://www.consumerfinance.gov/the-bureau/> (last visited Mar. 19, 2014) (describing CFPB's purpose as the protection of consumers in financial transactions).

<sup>13</sup> 12 C.F.R. §§ 1005.1–1005.36.

<sup>14</sup> § 1005.1(b).

<sup>15</sup> § 1005.6(b). Exceptions to this will be explored. See *infra* text accompany notes 85–107.

<sup>16</sup> Again, assuming they adhere to the requirements of Reg. E., Target customers are at risk of losing only a nominal amount of money (either \$50 or \$500 depending on their reporting time) associated with the unauthorized use of the electronic payment devices (*i.e.*, debit and credit cards). § 1005.6(b). But again: the theft of personal information including, names, mailing addresses, phones numbers and email addresses carry very serious financial and other risks.

This Issue Brief addresses the issues associated with application of Reg. E to electronic non-financial institution payment services (“alternative payment services”)<sup>17</sup> such as PayPal and its peers.<sup>18</sup> More specifically, it addresses two questions. First, does Reg. E protect PayPal users if funds are stolen via unauthorized EFTs from their PayPal accounts? Second, if not, does the EFTA grant the CFPB the authority necessary to make the changes needed to ensure that all of the functions of PayPal are regulated by Reg. E?

PayPal is a leading alternative payments services company, available in “193 markets” and 26 currencies around the world.<sup>19</sup> PayPal has 157 million active accounts, and it processed 27 billion dollars of payments in 2013.<sup>20</sup> The main benefits of PayPal are that it removes the need for buyers to share sensitive personal information with unknown sellers and provides a means with which buyers and sellers can resolve disputes that arise from online transactions.<sup>21</sup> Thus, PayPal presents itself as a safer way to process EFTs over the internet.<sup>22</sup>

In its annual report, PayPal insists that it currently complies with, and even goes beyond,<sup>23</sup> the consumer protections featured in Reg. E despite its acknowledgment that “there have been no definitive interpretations [of whether it is covered by Reg. E] to date.”<sup>24</sup> PayPal has also acknowledged that coverage under Reg. E could expose it “to significant liability.”<sup>25</sup> Moreover, PayPal concedes that any changes to its practices regarding Reg. E could require it “to incur significant costs and to expend substantial resources,” which could consequently harm its business.<sup>26</sup> Accordingly, it is fair to question whether PayPal would still feel

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<sup>17</sup> The term “alternative payment services” references electronic payment services that are not administered by a financial institution.

<sup>18</sup> The reference to PayPal is simply for illustrative purposes. As is discussed, *infra* text accompanying notes 40–65, there are many types of alternative payment services. This Issue Brief’s analysis may be applied to any alternative payment service that holds its own accounts—similar to the way in which PayPal does.

<sup>19</sup> *Welcome to the PayPal Information Center*, PAYPAL, <https://www.paypal-media.com/about> (last visited Mar. 10, 2014). PayPal is currently a wholly owned subsidiary of eBay Inc., but it recently announced plans to spin-off and create its own separate publically traded corporation. *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *See id.* (“PayPal gives people better ways to connect to their money and each other, helping them send money without sharing financial information”).

<sup>23</sup> *See infra* text accompanying notes 137–140.

<sup>24</sup> eBay Inc., *Form 10-K*, EDGARONLINE 18 (2014), <http://files.shareholder.com/downloads/eBay/3921794849x0xS1065088-14-10/1065088/filing.pdf> [hereinafter 2014 10-K].

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

so generous if something on the scale of the Target Corporation breach were to occur to it.<sup>27</sup>

This Issue Brief argues that it is unclear whether Reg. E, as currently written, applies to PayPal's processing of EFTs from its own accounts, because of the insufficient specificity and circular language of Reg. E's definitions of the terms "financial institution" and "account." Part I will introduce alternative payment services. Next, Part II will introduce Reg. E and its relevant protections. Part III will then examine our current understanding of Reg. E's application to PayPal. Part IV, Section A will analyze Reg. E to demonstrate that its application to PayPal is unclear. Part IV, Section B will argue that, despite the lack of clarity, Congress and regulators likely intend Reg. E to cover PayPal, as evidenced by the purpose and language of the EFTA and Reg. E. Part IV, Section C will then recommend that the CFPB clarify the definitions of "financial institution" and "account" to ensure that PayPal and its peer companies are responsible to their users in the event of a data breach. Part IV, Section D will conclude by arguing that this Issue Brief's prescription is within the CFPB's grant of authority under the EFTA.

## I. ALTERNATIVE PAYMENT SERVICES

The methods with which consumers can process payments evolved dramatically during the twentieth century.<sup>28</sup> From the introduction of printed Federal Reserve Notes in 1914<sup>29</sup> to the implementation of mobile

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<sup>27</sup> *I.e.*, would they still apply the protective features of Reg. E to limit users' losses, resulting in potentially large losses of their own, despite there being no definitive determination requiring them to do so? Or would it be within the law for PayPal to reverse course and argue successfully that the type of service they offer is beyond the reach of what the EFTA authorizes the CFPB to regulate?

<sup>28</sup> See *Infographic: The History of Money and Payments*, INTUIT, <http://payments.intuit.com/history-of-money-and-payments/> (last visited Mar. 10, 2015) (presenting timeline of how humans have paid for things throughout history); Masashi Nakajima, *The Evolution of Payment Systems*, EUR. FIN. REV. (Feb. 15, 2012), <http://www.europeanfinancialreview.com/?p=2032> (discussing recent evolution of payment systems); Anthony M. Santomero, President, Fed. Reserve Bank of Phila., Address at the Pennsylvania Association of Community Bankers 128<sup>th</sup> Annual Convention: The Evolution of Payments in the U.S.: Paper vs. Electronic (Sept. 10, 2005) (transcript available at [http://www.philadelphiafed.org/publications/speeches/santomero/2005/09-10-05\\_pacb-128th-annual.cfm](http://www.philadelphiafed.org/publications/speeches/santomero/2005/09-10-05_pacb-128th-annual.cfm)) (addressing recent changes in the nation's payment system).

<sup>29</sup> A Federal Reserve Note is the same paper money in circulation today (colloquially known as "dollar bills"). *Federal Reserve Note*, INVESTOPEDIA, <http://www.investopedia.com/terms/f/federal-reserve-note.asp> (last visited Mar. 10, 2015).

payments in the late 1990s,<sup>30</sup> there is no better example of the profound impact technology has had on banking than the changes seen in the area of payments.<sup>31</sup> This payments evolution has resulted in a modern society that relies heavily on the use of payment mechanisms,<sup>32</sup> or payment systems,<sup>33</sup> that move funds electronically from one account to another.<sup>34</sup>

Today, the proliferation of the internet and other enabling technologies, as well as changes in regulation and increasing involvement of non-banks, has pushed the evolution of payment systems away from traditional depository institution issued methods of electronic payments, like debit and credit cards, and toward electronic payment methods such as PayPal that are dis-intermediated<sup>35</sup> from the banks.<sup>36</sup> The growth of alternative payment services has been exponential as consumers continually demand quicker and more efficient payment settlements.<sup>37</sup> These demands

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<sup>30</sup> The term “mobile payments” generally refers to any payment service initiated by a mobile device, such as a smart phone. *See, e.g.*, Erin F. Fonte, *Overview of Mobile Payments in the United States*, 32 BANKING & FIN. SERVICES POL’Y REP. 1, 3–4 (2013) (discussing the various types of mobile payment platforms).

<sup>31</sup> *See generally* INTUIT, *supra* note 28.

<sup>32</sup> A payment mechanism is “[a]ny machinery facilitating the transportation of money which bypasses the transportation of money and its physical delivery from the payor to the payee.” BENJAMIN GEVA, *THE LAW OF ELECTRONIC FUNDS TRANSFERS* §1.03[1] (2014).

<sup>33</sup> A payment system is a “payment mechanism facilitating a standard method of payment through a banking system.” *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> Dis-intermediation is a term of art in finance that refers to the elimination of financial institutions as an intermediary either in the purchase or sale of goods and services or participation in the financial markets. This is considered a threat to an important source of revenue for financial institutions (*i.e.*, payment processing). Robert Gellman, *Disintermediation and the Internet*, 13 GOV’T INFO. Q., 1, 1–2 (2003).

<sup>36</sup> *See* Richard Warren & Justin Davidson, *2011: Evolution of Payments*, FIRSTPARTNER, [http://www.mvndynamics.com/wpcontent/uploads/2011/02/2011\\_evolution\\_of\\_payments\\_market\\_map\\_evaluation.pdf](http://www.mvndynamics.com/wpcontent/uploads/2011/02/2011_evolution_of_payments_market_map_evaluation.pdf) (last visited Mar, 10, 2015) (providing a visual representation of the vast array of electronic payment services); Tim Grant, *Person-to-person payment services growing in demand*, PITTSBURGH POST-GAZETTE (Nov. 25, 2013), <http://www.post-gazette.com/business/2013/11/26/Person-to-person-payment-services-growing-in-demand/stories/201311260042> (discussing the increase in demand of direct money transfers via the internet or mobile phone).

<sup>37</sup> *See Cover Story: Annual Guide to Alternative Payments*, DIGITAL TRANSACTIONS (May 1, 2013), <http://www.digitaltransactions.net/news/story/4121> (“Entry after entry in our 2013 Field Guide is offering . . . a payment service that speeds up settlement time from next day to same day to instant . . . [as] [m]obile users have been trained to expect instant results in other spheres of their digital life.”).

have created an alternative payment service marketplace that is extremely volatile.<sup>38</sup> As of 2014, although the types of alternative payment services vary widely, several different categories of alternative payment services have emerged.<sup>39</sup>

The first category of alternative payment services has been referred to as peer-to-peer (“P2P”) payments.<sup>40</sup> P2P payments are designed to allow consumers to send payments from account to account securely via email, text message, over the web and sometimes by social media.<sup>41</sup> Although some P2P services are facilitated by financial institutions,<sup>42</sup> they were developed by and are still primarily used via alternative payment services, most notably PayPal.<sup>43</sup> Today, there are several alternative payment services facilitating P2P transfers including Amazon Payments,<sup>44</sup> Square,<sup>45</sup> Venmo,<sup>46</sup>

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<sup>38</sup> In fact, by the time this Issue Brief is published it is quite likely that many of its references may be dated. *See id.* (“[I]t demonstrates just how volatile alternative payment is as a market. Among our 38 entries this year . . . are eight that are on the list for the first time, while half a dozen have dropped off.”).

<sup>39</sup> TONY HAYES & ROSS FRISBIE, OLIVER WYMAN, ALTERNATIVE ELECTRONIC PAYMENTS 13 (2011), available at <https://members.woccu.org/functions/filemanager.php?id=6460&cs=10649>.

<sup>40</sup> *See* Ronald J. Mann, *Regulating Internet Payment Intermediaries*, 82 TEX. L. REV. 681, 681–82 (2004) (discussing peer-to-peer payment policy ramifications). Sometimes these are referred to as “person-to-person” payments. Ruth Susswein, *Survey finds satisfaction among P2P payments users*, CONSUMER ACTION (May 31, 2013), [http://www.consumer-action.org/news/articles/peer\\_to\\_peer\\_payments\\_survey\\_may\\_2013](http://www.consumer-action.org/news/articles/peer_to_peer_payments_survey_may_2013) (“Peer to peer payments [are] sometimes called person-to-person payments”).

<sup>41</sup> Susswein, *supra* note 40.

<sup>42</sup> Today, financial institutions like Bank of America, JPMorgan Chase, and Wells Fargo, among others, all facilitate P2P payments for their customers. *See, e.g., Mobile App, Web and Text Banking Options*, BANK AM., <https://www.bankofamerica.com/online-banking/mobile-internet-banking.go> (last visited Mar. 10, 2015); *Chase Person-to-Person QuickPay*, CHASE, <https://www.chase.com/online-banking/quickpay> (last visited Mar. 10, 2015). *See also* Tara Siegel Bernard, *Person-to-Person Payments Get Easier at Big Banks*, N.Y. TIMES (May 25, 2011, 5:58 PM), <http://bucks.blogs.nytimes.com/2011/05/25/person-to-person-payments-get-easier-at-big-banks> (discussing P2P services available with Bank of America, JPMorgan Chase and Wells Fargo). However, to date only 17% of Financial Institutions offer P2P payments, with an additional 39% working on implementing the technology. *Person-to-Person (P2P) Payments*, MONTISE, <http://www.monitise.com/americas/products/p2p-payments.php> (last visited Mar. 10, 2015).

<sup>43</sup> *See* Susswein, *supra* note 41 (“80% named PayPal—the granddaddy of internet payment systems.”).

<sup>44</sup> *Amazon Payments*, AMAZON, <https://payments.amazon.com/home> (last visited Mar. 10, 2015).

<sup>45</sup> *Start accepting credit cards today*, SQUARE, <https://squareup.com/> (last visited Mar. 10, 2015).

PopMoney,<sup>47</sup> Dwolla,<sup>48</sup> Serve<sup>49</sup> and SoftPay,<sup>50</sup> among others. The methods with which P2P alternative payment services fund payments vary widely.<sup>51</sup> Some of these P2P alternative payments services, such as PayPal, Amazon Payments, SOFTPAY, Dwolla and Venmo, allow users to fund P2P transfers by applying the user's account balance held by the alternative payment service itself.<sup>52</sup> Other P2P alternative payment services, such as Square and PopMoney, do not hold account balances but simply process underlying financial institution credit or debit transactions.<sup>53</sup> Most P2P alternative payment services, however, allow some mix of both.<sup>54</sup>

The next category of alternative payment services has been referred to as "Digital Wallets."<sup>55</sup> Although the types of Digital Wallets vary widely, most come in the form of an app that can be downloaded to a mobile device, such as a smart phone or a tablet.<sup>56</sup> Digital Wallets promote themselves as a way for consumers to simplify their lives by storing electronically much of what would be contained in a traditional wallet.<sup>57</sup> Most smart phones are now equipped with a Near Field Communication ("NFC") chip that allows users to transmit the information stored within the Digital Wallet to a compatible point-of-sale terminal ("POS") when making in-person purchases or transactions.<sup>58</sup> Some Digital Wallets, however, do not utilize NFC technology, but rather process all of their payments online, thus

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<sup>46</sup> *Make and share payments*, VENMO, <https://venmo.com/> (last visited Mar. 10, 2015).

<sup>47</sup> *Send, request and receive money the easy way*, POPMONEY, <https://www.popmoney.com/> (last visited Mar. 10, 2015).

<sup>48</sup> *The best way to move money*, DWOLLA, <https://www.dwolla.com/> (last visited Mar. 10, 2015).

<sup>49</sup> AMERICAN EXPRESS SERVE, <https://www.serve.com> (last visited Mar. 10, 2015).

<sup>50</sup> *Pay with your phone*, SOFTPAY, <http://www.softtouchpos.com/pageSoftPay.html> (last visited Mar. 15, 2014).

<sup>51</sup> See Monica Steinisch, *Comparing electronic P2P payment options*, CONSUMER ACTION (May 31, 2013), [http://www.consumer-action.org/news/articles/peer\\_to\\_peer\\_payments\\_survey\\_may\\_2013](http://www.consumer-action.org/news/articles/peer_to_peer_payments_survey_may_2013) (discussing differences between P2P payment options).

<sup>52</sup> *Id.*

<sup>53</sup> See *id.* (explaining that Popmoney only accepts funds from a linked checking or savings account).

<sup>54</sup> See *id.* ("PayPal lets you fund payments with all options.")

<sup>55</sup> Nathan Chandler, *How Digital Wallets Work*, HOWSTUFFWORKS, <http://electronics.howstuffworks.com/gadgets/high-tech-gadgets/digital-wallet.htm>, at 1 (last visited Mar. 15, 2014).

<sup>56</sup> *Id.*

<sup>57</sup> Such as "credit cards, family pictures, driver's license[s], insurance identification, shopping loyalty cards, gift cards and more." *Id.*

<sup>58</sup> *Id.* at 3.



allowing payments and purchases to be made from any distance.<sup>59</sup> Many household technology companies have entered the competition in digital wallets, including Google (with Google Wallet), Apple (with Passbook), and Square (with Square Wallet).<sup>60</sup>

The last category of alternative payment services has been referred to as “Digital Currencies.”<sup>61</sup> With Digital Currencies, consumers exchange money for points, credits, or an equivalent amount of the virtual currency.<sup>62</sup> The most well-known Digital Currency is Bitcoin.<sup>63</sup> Digital Currency is properly considered an alternative payment service and is currently facilitating a sizable amount of payments.<sup>64</sup> However, due to the quick evolution of regulation surrounding Digital Currencies as well as the labyrinth of emerging research on the topic,<sup>65</sup> Digital Currencies are beyond the scope of this Issue Brief.

The distinction between alternative payment services that hold consumers’ funds<sup>66</sup> and alternative payment services that do not hold consumers’ funds<sup>67</sup> is important in analyzing the contours of Reg. E. Services that do not hold consumers’ funds are simply processors of

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<sup>59</sup> See *id.* (“[S]ome wallets are anti-NFC.”).

<sup>60</sup> Brian Voo, *Digital Wallets – 10 Mobile Payment Systems to Take You There*, HONGKIAT.COM, <http://www.hongkiat.com/blog/digital-wallets/> (last visited Mar. 15, 2014); see also Chandler, *supra* note 55, at 5 (discussing various companies entering the digital wallet business).

<sup>61</sup> See generally Dhara Ranasinghe, *What you need to know about digital currencies*, CNBC (Dec. 24, 2013), <http://www.cnbc.com/id/101287931> (describing the nature of digital currency); John Naughton, *Bitcoin may bite the dust, but the notion of a digital currency will endure*, GUARDIAN (Mar. 8, 2014), <http://www.theguardian.com/technology/2014/mar/08/bitcoin-bite-dust-digital-currency-endure> (arguing for the staying power of digital currency).

<sup>62</sup> See Ranasinghe, *supra* note 61 (“Referred to as a ‘virtual’ currency, Bitcoin allows users to exchange online credits for goods and services.”).

<sup>63</sup> BITCOIN, <https://bitcoin.org/en/> (last visited Mar. 10, 2015).

<sup>64</sup> *Getting started with Bitcoin*, BITCOIN, <https://bitcoin.org/en/getting-started> (last visited Mar. 10, 2015).

<sup>65</sup> See, e.g., Paul H. Farmer, Jr., *Speculative Tech: The BitCoin Legal Quagmire & The Need for Legal Innovation*, 9 J. BUS. & TECH. L. 85 (2014); Danton Bryans, *BitCoin and Money Laundering: Mining for an Effective Solution*, 89 IND. L.J. 441 (2014); Stephen T. Middlebrook & Sarah Jane Hughes, *Virtual Uncertainty: Developments in the Law of Electronic Payments and Financial Services*, 69 BUS. LAW. 263 (2013).

<sup>66</sup> Such as those referenced in the preceding section. See *supra* text accompanying note 52.

<sup>67</sup> Such as most Digital Wallets.

underlying credit or debit card payments or bank account EFTs.<sup>68</sup> For reasons we will see, services that do not hold consumers' funds fit comfortably within the ambit of Reg. E.<sup>69</sup> However, for the services that hold consumers' funds, such as PayPal, the inquiry is more complicated, and is the focus of this Issue Brief's analysis. Equally important, there are several services that are capable of processing transactions from their own consumer-funded accounts *or* attached credit cards, debit cards, or an attached bank account.<sup>70</sup> For these hybrid services there may be instances where Reg. E applies and instances where it does not. Later discussion of Reg. E will further clarify this point.

## II. THE ELECTRONIC FUND TRANSFER ACT & REGULATION E

In 1978, Congress enacted 15 U.S.C. § 1693 *et seq.*, the Electronic Fund Transfer Act ("EFTA"),<sup>71</sup> because of both the substantial benefits that electronic fund transfers ("EFTs") can provide consumers and the fact that application of consumer laws to EFTs, as they existed at that time, were unclear.<sup>72</sup> On July 21st, 2011, in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act, responsibility for enforcement and implementation of the EFTA and Regulation E ("Reg. E") shifted from the Board of Governors of the Federal Reserve to the Consumer Financial Protection Bureau ("CFPB").<sup>73</sup> In accordance with this shift, Reg. E, formerly 12 C.F.R. Section 205, is now renumbered as section 1005.<sup>74</sup>

Reg. E regulates several areas relating to EFTs made by consumers (business EFTs are not covered by the EFTA or Reg. E<sup>75</sup>) including disclosures,<sup>76</sup> the issuance of access devices,<sup>77</sup> receipts at electronic terminals,<sup>78</sup> periodic statements,<sup>79</sup> preauthorized transfers,<sup>80</sup> the procedures

<sup>68</sup> This is to say that these payment services do nothing more than act as an intermediary for another payment service in the same way a retailers POS terminal would.

<sup>69</sup> See *infra* text accompanying notes 121–124.

<sup>70</sup> See *supra* text accompanying note 54.

<sup>71</sup> The Electronic Fund Transfer Act, Pub. L. 95–630, § 2001, 92 Stat. 3641, 3728 (1978).

<sup>72</sup> 15 U.S.C. § 1693(a); GEVA, *supra* note 32, at § 6.01.

<sup>73</sup> GEVA, *supra* note 32, at § 6.01.

<sup>74</sup> *Id.*

<sup>75</sup> See 12 C.F.R. § 1005.3 (excluding from coverage any transfer of funds through a wire transfer system used primarily between business). See also § 1005.2(e) (defining "consumer" as a natural person).

<sup>76</sup> See, e.g., §§ 1005.4, 1005.7–8 & 1005.16.

<sup>77</sup> See, e.g., § 1005.5. "Access device" means a card, code [such as pin number], or other means of access to a consumer's account, or any combination thereof, that may be used by the consumer to initiate [EFTs]." § 1005.2(a)(1).

<sup>78</sup> § 1005.9(b).

for resolving errors,<sup>81</sup> record retention,<sup>82</sup> requirements for overdraft services,<sup>83</sup> and, most importantly, liability of consumers for unauthorized EFTs.<sup>84</sup>

Reg. E section 1005.6(b), places limitations on the amount of loss a consumer is liable for in the event of an unauthorized EFT,<sup>85</sup> such as a loss associated with the theft of a debit or credit card.<sup>86</sup> When the consumer provides the financial institution with “timely notice”—i.e., within two business days<sup>87</sup>—of learning of the loss or theft of his or her access device,<sup>88</sup> the consumer’s liability is capped at the lesser of \$50 or the amount of unauthorized transfers that occurred before notice was given to the financial institution.<sup>89</sup> For example, if the consumer leaves their credit card at a restaurant Saturday night but doesn’t realize the mistake until lunch on Monday, the consumer must notify the financial institution by midnight on Wednesday to be considered timely.<sup>90</sup> If the consumer does, their liability will be capped at \$50.<sup>91</sup>

Alternatively, if the consumer neglects to notify the financial institution in a timely manner—i.e., greater than two business days—the consumer’s liability “shall not exceed the *lesser* of \$500 or the sum of . . . \$50 or the amount of authorized transfers that occur within the two business days, whichever is less; and . . . [t]he amount of unauthorized transfers that occur after the close of two business days and before notice to the

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<sup>79</sup> *Id.*

<sup>80</sup> § 1005.10.

<sup>81</sup> § 1005.11.

<sup>82</sup> § 1005.13(b).

<sup>83</sup> § 1005.17.

<sup>84</sup> § 1005.6.

<sup>85</sup> “‘Unauthorized [EFT]’ means an [EFT] from a consumer’s account initiated by a person other than the consumer without actual authority to initiate the transfer and from which the consumer receives no benefit.” § 1005.2(m).

<sup>86</sup> § 1005.6(b).

<sup>87</sup> “‘Business day’ means any day on which the offices of the consumer’s financial institution are open to the public for carrying on substantially all business functions.” § 1005.2(d). *See also* § 1005.6(b)(2) (Supp. I 2014) Official Interpretation 3 (“The two business day period does not include the day the consumer learns of the loss or theft or any day that is not a business day. The rule is calculated based on two 24-hour periods, without regard to the financial institutions business hours or the time of day that the consumer learns of the loss or theft.”).

<sup>88</sup> Meaning once the consumer realizes their debit or credit card, pin number or other qualifying access device is missing. This should not be confused with two days’ notice of learning that an account has been a victim of an unauthorized EFT.

<sup>89</sup> § 1005.6(b)(1).

<sup>90</sup> § 1005.6(b)(2) (Supp. I 2014) Official Interpretation 1.

<sup>91</sup> *Id.*

institutions provided [that] the financial institution establishes these transfers would not have occurred had the consumer notified the institution within that two-day period.”<sup>92</sup> For example, if a consumer leaves their credit card at a restaurant Saturday night and doesn’t realize the mistake until lunch on Monday, but fails to notify the financial institution within two business days (by midnight Wednesday), the notification is not considered timely.<sup>93</sup> In this instance, the consumer responsibility will be determined by looking at when the unauthorized transfers took place, but can now result in liability up to \$500.<sup>94</sup>

Notice to the financial institution can be provided in any reasonable manner, including, *inter alia*, in person, by telephone, or in writing.<sup>95</sup> Additionally, financial institutions are considered to have constructive notice when they “[become] aware of circumstances leading to the reasonable belief that an unauthorized transfer to or from the consumer’s account . . . may be made.”<sup>96</sup> Thus, in the event of a breach analogous to Target’s,<sup>97</sup> the news coverage surrounding the event may qualify as constructive notice.<sup>98</sup>

Reg. E also protects consumers in situations where loss or theft of an access device goes undetected and, thus, unreported until unauthorized EFTs are discovered by the consumer on a periodic statement.<sup>99</sup> In this situation, the consumer has 60 days from the date the financial institution transmitted the statement to avoid liability for subsequent transfers.<sup>100</sup> This means that if a periodic statement shows an unauthorized transfer, the consumer has 60 days from the time the statement was sent to report it.<sup>101</sup> If the consumer fails to do so, they are subject to unlimited liability for

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<sup>92</sup> § 1005.6(b)(2) (emphasis added).

<sup>93</sup> § 1005.6(b)(2) (Supp. I 2014) Official Interpretation 1.

<sup>94</sup> *Id.*

<sup>95</sup> § 1005.6(b)(5).

<sup>96</sup> § 1005.6(b)(5)(iii).

<sup>97</sup> *I.e.*, a breach that draws enormous media coverage. *See, e.g.*, Alastair Jamieson & Erin McClam, *Millions of Target customers’ credit, debit card accounts may be hit by data breach, Target: 40 million credit cards compromised*, CNN MONEY (Dec. 19, 2013), <http://money.cnn.com/2013/12/18/news/companies/target-credit-card/>; Elizabeth A. Harris & Nicole Perloth, *For Target, the Breach Numbers Grow*, NY TIMES (Jan. 10, 2014), <http://www.nytimes.com/2014/01/11/business/target-breach-affected-70-million-customers.html>.

<sup>98</sup> *See* § 1005.6(b)(5)(iii) (2013).

<sup>99</sup> Periodic statements are not defined by the EFTA or Reg. E, but apply to any regularly occurring explanation of account activity, like a standard bank statement. § 1005.6(b)(3).

<sup>100</sup> *Id.*

<sup>101</sup> § 1005.6(b)(3).

unauthorized transfers that occur beyond the 60-day window.<sup>102</sup> For all unauthorized transfers that occur within the 60-day window, liability is determined based on whether the reporting is timely or untimely.<sup>103</sup> For example, if a consumer first learns of unauthorized EFTs when he views his bank statement and realizes that someone has been siphoning money from his account via an unauthorized EFT, he has 60 days to report the loss or he is liable for 100% of losses that occur after the 60-day window has expired.<sup>104</sup> If, however, he does notify the financial institution within the 60-day window, his losses will be capped at either \$50 or \$500 depending on whether or not he notifies the financial institution in a timely manner.<sup>105</sup> Once the consumer has provided the financial institution with notice, the financial institution has ten business days to investigate.<sup>106</sup> Once the financial institution completes its investigation, it has three business days to report the results to the consumer, and, if necessary, one business day to correct the error.<sup>107</sup>

If a qualifying financial institution is found to be in violation of the requirements of Reg. E, Section 1005.13 provides the procedures for administrative enforcement.<sup>108</sup> Reg. E points to the EFTA and adopts wholesale its requirements for enforcement.<sup>109</sup> As the result of a failure to comply with the EFTA, a financial institution can be held responsible for all damages proximately caused by the failure.<sup>110</sup> To enforce their claims, consumers can bring individual or class action claims in any U.S. District Court within one year of the alleged violation.<sup>111</sup> The agency responsible for enforcing Reg. E will depend upon the type of financial institution it is being enforced against.<sup>112</sup> PayPal and most of the other alternative payment services are covered by the CFPB.<sup>113</sup>

In 2009 the EFTA and Reg. E were amended with the passage of the Credit CARD Act to include store gift cards and payroll card

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<sup>102</sup> *Id.* § 1005.6(b)(3) (Supp. I 2014) Official Interpretation 1.

<sup>103</sup> §§ 1005.6(b)(1)–(2).

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> § 1005.11(c)(1).

<sup>107</sup> *Id.*

<sup>108</sup> § 1005.13.

<sup>109</sup> *Id.*

<sup>110</sup> 15 U.S.C. § 1693h(a) (2012). Unless the institution can prove a lack of intent *and* bona fide error, in which case they are only liable for actual damages. § 1693h(c).

<sup>111</sup> *See generally* § 1693m (providing civil liability remedies for FI violation of the EFTA).

<sup>112</sup> *See generally* § 1693o (describing the various regulatory agencies responsible for enforcement).

<sup>113</sup> § 1693o(a)(5).

accounts.<sup>114</sup> Section 1005.20 of Reg. E defines a gift card as a card that is issued on a prepaid basis primarily for personal, family, or household purposes to a consumer in a specified amount, whether or not the amount may be increased or reloaded and redeemable upon presentation at a single merchant or an affiliated group of merchants for goods or services.<sup>115</sup> Additionally, Section 1005.18 defines a payroll card account as “an account that is directly or indirectly established through an employer and to which electronic fund transfers of the consumer’s wages, salary, or other employee compensation (such as commissions), are made on a recurring basis.”<sup>116</sup>

Furthermore, Reg. E seeks to enforce the agreement a financial institution makes with consumers regarding liability for its EFTs. Section 105.6(b)(6) states that, “[i]f . . . an agreement between the consumer and the financial institution imposes less liability than is provided by this section, the consumer’s liability shall not exceed the amount imposed under the . . . agreement.”<sup>117</sup> Reg. E also requires that the financial institution provide the consumer with disclosure summarizing their liability.<sup>118</sup> Additionally, Reg. E mandates that the financial institution provide the consumer with written notice of any change to the agreement regarding liability at least 21 days before the effective date,<sup>119</sup> unless the immediate change is needed to “maintain or restore security of an account or an electronic fund transfer system.”<sup>120</sup>

Finally, as referenced earlier,<sup>121</sup> Section 1005.14 of Reg. E makes clear that when an entity provides an EFT service to a consumer but does not hold the consumer’s account it is still subject to all the requirements of Reg. E.<sup>122</sup> For example, this would occur when PayPal processes an EFT from an attached debit or credit card. This section requires that the financial institution “[i]ssue a[n] . . . access device . . . and [have] no agreement with the account-holding institution regarding such access.”<sup>123</sup> For this reason,

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<sup>114</sup> See § 1693l-1 (codifying the Credit CARD Act). See also Todd J. Zywicki, *The Economics and Regulation of Network Branded Prepaid Cards*, 65 FLA. L. REV. 1477, 1491 (2013) (describing the regulation of prepaid cards); Air M. Cohen, *Protecting the Underserved: Extending the Electronic Fund Transfer Act Regulation E to Prepaid Debit Cards*, 5 BROOK. J. CORP. FIN. & COM. L. 215, 233 (2010) (same).

<sup>115</sup> 12 C.F.R. § 1005.20(a) (2013).

<sup>116</sup> § 1005.18.

<sup>117</sup> § 1005.6(b)(6).

<sup>118</sup> § 1005.7(b)(1).

<sup>119</sup> § 1005.8.

<sup>120</sup> *Id.*

<sup>121</sup> See *supra* text accompanying notes 66–70.

<sup>122</sup> § 1005.14(a).

<sup>123</sup> *Id.*

when PayPal authorizes EFTs from a consumer's attached checking or savings account, or from an attached credit card, PayPal *is* regulated by Reg. E, because the password the consumer uses to access PayPal qualifies as "access device" under Reg. E.<sup>124</sup>

### III. PAYPAL AND THE LAW: OUR CURRENT UNDERSTANDING

In the early 2000s, observers of payment regulation began to question the applicability of Reg. E. to alternative payment services such as PayPal.<sup>125</sup> Their questions stemmed from uncertainty as to whether or not the term "account," as defined by the EFTA and Reg. E to include debit, credit, or other asset account held by a financial institution, includes the type of accounts held by PayPal.<sup>126</sup> Some observers hastily concluded that the type of accounts held by PayPal qualify as an account under the Electronic Fund Transfer Act ("EFTA") and Regulation E ("Reg. E"), thus, making Reg. E applicable to PayPal.<sup>127</sup>

However, litigation brought against PayPal in the 2000s over alleged violations of the EFTA and Reg. E demonstrated that the law is not clear.<sup>128</sup> The first action, brought in 2002 as a class action, alleged that PayPal had violated several aspects of the EFTA and Reg. E.<sup>129</sup> PayPal denied liability under the EFTA for the alleged claims.<sup>130</sup> The action was settled in 2004 without an admission by PayPal that it is subject to the EFTA and Reg. E.<sup>131</sup> The second action, brought by twenty-eight state attorneys general in 2006, also alleged confusion over the applicability of

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<sup>124</sup> § 1005.2(a).

<sup>125</sup> See, e.g., Jeffrey P. Taft, *An Overview of the Electronic Fund Transfer Act and Regulation E and Their Application to E-Commerce*, 57 CONSUMER FIN. L.Q. REP. 205, 211 (2003); Jeffrey P. Taft, *Internet-Based Payment Systems: An Overview of the Regulatory and Compliance Issues*, 56 CONSUMER FIN. L.Q. REP. 42, 44–45 (2002) [hereinafter *Overview*].

<sup>126</sup> See *Overview*, *supra* note 125 at 44–45.

<sup>127</sup> See Anita Ramasastry, *Confusion and Convergence in Consumer Payments: Is Coherence in Error Resolution Appropriate?*, 83 CHI.-KENT L. REV. 813, 823 (2008); Ronald J. Mann, *Regulating Internet Payment Intermediaries*, 82 TEX. L. REV. 681, 696–97 (2004).

<sup>128</sup> See, e.g., *In re PayPal Litigation*, No. CV-02-01227-JF (PVT) (N.D. Cal. June 11, 2004).

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

consumer protections.<sup>132</sup> The suit was again settled without an admission by PayPal that it is subject to the EFTA and Reg. E.<sup>133</sup>

Additionally, alternative payment services such as PayPal have explicitly noted the ambiguity in application of the EFTA and Reg. E. In its 2009 10-K, PayPal stated, “[a]lthough there have been no definitive interpretations to date, *PayPal has assumed that its service is subject to the [EFTA] and [Reg. E].*”<sup>134</sup> However, in the following year, PayPal modified the language of its 10-K to state, “[a]lthough there have been no definitive interpretations to date, *PayPal has taken actions as though its service is subject to the [EFTA] and [Reg. E].*”<sup>135</sup> PayPal’s stance on the applicability of the EFTA and Reg. E has remained the same since 2010, thus positioning it to again contest applicability of Reg. E.<sup>136</sup>

Currently PayPal’s user agreement purports to go beyond the protections of Reg. E.<sup>137</sup> In fact PayPal purports to cover 100% of any loss resulting from unauthorized transactions—such as theft or erroneous withdrawals—so long as the user provides proper notification to PayPal.<sup>138</sup> Proper notification requires users to notify PayPal of the loss within 60 days.<sup>139</sup> This agreement eliminates the \$50 or \$500 loss stipulations of Reg. E for “timely” or “untimely” notifications.<sup>140</sup>

If PayPal is regulated by Reg. E, then Section 1005.6(b)(5) makes clear that PayPal will be forced to honor its user agreement.<sup>141</sup> If PayPal is, however, not regulated by Reg. E, then it may be permissible to reverse the unlimited liability protections it currently offers at a moment’s notice, leaving unsuspecting consumers subject to potentially unlimited liability for theft or losses from their PayPal accounts.

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<sup>132</sup> Assurance of Voluntary Compliance or Discontinuance § 4, *In re PayPal, Inc.*, available at [http://myfloridalegal.com/webfiles.nsf/WF/MRAY-6U3L4N/\\$file/PayPal\\_AVC.pdf](http://myfloridalegal.com/webfiles.nsf/WF/MRAY-6U3L4N/$file/PayPal_AVC.pdf).

<sup>133</sup> *Id.*

<sup>134</sup> eBay Inc., *Form 10-K*, EDGARONLINE 24 (2014), <http://files.shareholder.com/downloads/eBay/3921794849x0xS950134-09-3306/1065088/filing.pdf> (emphasis added).

<sup>135</sup> eBay Inc., *Form 10-K*, EDGARONLINE 29 (2010), <http://files.shareholder.com/downloads/eBay/3921794849x0xS1193125-10-33324/1065088/filing.pdf> (emphasis added).

<sup>136</sup> See 2014 10-K, *supra* note 24 (describing PayPal’s stance).

<sup>137</sup> See generally *PayPal User Agreement*, PAYPAL (Nov. 18, 2014), <https://www.paypal.com/us/webapps/mpp/ua/useragreement-full>.

<sup>138</sup> *Id.* at 12.1.

<sup>139</sup> *Id.* at 12.2.

<sup>140</sup> See *supra* text accompanying notes 89 & 92.

<sup>141</sup> See 12 C.F.R. § 1005.6(b)(5) (2013).



## IV. ANALYSIS

*A. Reg. E and Alternative Payment Services: A Labyrinth of Definitions*

It is unclear if PayPal, when processing EFTs from its own accounts, is regulated by Reg. E because of the insufficient specificity and circular language of Reg. E's definitions.<sup>142</sup> Reg. E applies to "any electronic fund transfer that authorizes a *financial institution* to debit or credit a consumer's *account*." It is unclear if PayPal qualifies as a financial institution under Reg. E. Whether PayPal qualifies as a *financial institution* depends on whether a PayPal account qualifies as an *account* under Reg. E. However, it is unclear whether a PayPal account qualifies as an account under Reg. E. This is because Reg. E fails to define the terms "demand deposit" and "asset account." Furthermore, whether a PayPal account qualifies as an *account* under Reg. E also depends on whether the account is held by a *financial institution*. Thus, because of the insufficient specificity and circular language of Reg. E's definitions, it is unclear if PayPal, when processing EFTs from its own account, is regulated by Reg. E.

Reg. E applies to "any electronic fund transfer that authorizes a *financial institution* to debit or credit a consumer's *account*."<sup>143</sup> Therefore, the quest to determine whether PayPal accounts are regulated under Reg. E begins with the unpacking of the definitions of "financial institution" and "account."<sup>144</sup> The definitions of these terms are as follows:

1. **Financial Institution:** "means a bank, savings association, credit union, or any other person that directly or indirectly holds an *account* belonging to a consumer, or that issues an *access device* and agrees with a consumer to provide *electronic fund transfer services*."<sup>145</sup>
2. **Account:** "means a demand deposit (checking), savings, or other consumer asset account . . . held directly or indirectly by a *financial*

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<sup>142</sup> As discussed earlier, *see supra* text accompanying notes 122–124, when PayPal provides an EFT service to a consumer but does not hold the consumer's account—such as when PayPal processes an EFT from an attached debit or credit card—PayPal is clearly regulated under Reg. E. This analysis only pertains to situations when PayPal provides an EFT service and holds the consumer's account where the funds subject to the EFT originate.

<sup>143</sup> § 1005.3(a) (emphasis added).

<sup>144</sup> *See generally* § 1005.2. The definitions of "consumer" and "debit or credit" are easily concluded to apply to alternative payment services, thus their discussion is unnecessary. *See* § 1005.2(e) (defining "consumer"); § 1005.2(f) (defining "credit").

<sup>145</sup> § 1005.2(i) (emphasis added).

*institution* and established primarily for personal, family, or household purposes.”<sup>146</sup>

It is unclear if PayPal, when making EFTs from its own accounts, is a financial institution under Reg. E. PayPal is not a bank, savings association, or credit union.<sup>147</sup> Therefore, if PayPal fits the definition of a financial institution, it must be either a “*person* that directly or indirectly holds an *account* belonging to a *consumer*” or a person “that issues an *access device* and agrees with the consumer to provide *electronic fund transfer* services.”<sup>148</sup> These two possible definitional inclusions are addressed in order.

Whether PayPal fits under either of Reg. E’s possible definitions of “financial institution” depends on whether the type of account held by PayPal qualifies as an “*account*” under Reg. E. PayPal is a person under Reg. E as it is a corporation.<sup>149</sup> Additionally, PayPal accounts are directly held for consumers.<sup>150</sup> Therefore, whether PayPal fits within the definition of a “*person* that directly or indirectly holds an *account* belonging to a *consumer*” depends on whether the type of accounts it holds qualify as an *account* under Reg. E.

Additionally, Reg. E defines “*access device*” as “a card, code, or other means of access to a consumer’s *account*.”<sup>151</sup> Moreover, Reg. E defines “*electronic fund transfer*” as “transfer of funds that is initiated through . . . telephone [or] computer . . . for the purpose of ordering . . . a

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<sup>146</sup> § 1005.2(b) (emphasis added).

<sup>147</sup> In 2002 the Federal Deposit Insurance Corporation (“FDIC”) declared that PayPal is not a bank or savings association. Troy Wolveron, *Feds: PayPal not a bank*, CNET (Mar. 12, 2002), <http://news.cnet.com/2100-1017-858264.html>. However, the FDIC has not released the ruling because it qualifies under an exception to the Freedom of Information Act. *FOI Request*, MUCKROCK NEWS (May 6, 2013), <https://www.muckrock.com/foi/united-states-of-america-10/fdic-paypal-opinions-4843>. Many states have followed the FDIC’s lead. *See, e.g.*, John D. Muller, *Banking Interpretation*, N.Y. STATE DEPT. OF FIN. SERVICES (June 3, 2002), [http://www.dfs.ny.gov/legal/interpret\\_opinion/banking/lo020603.htm](http://www.dfs.ny.gov/legal/interpret_opinion/banking/lo020603.htm). PayPal is understandably careful about the way in which it describes itself. *See About Us*, PAYPAL, <https://www.paypal-media.com/about> (last visited Mar. 10, 2014) (describing the company as a “payments platform” and refusing to mention any possibility that it could be categorized as a “bank”).

<sup>148</sup> § 1005.2(i).

<sup>149</sup> *See* § 1005.2(j) (defining “person”); *see also* Company Overview of PayPal, Inc., BLOOMBERG BUSINESSWEEK, <http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=112732> (last visited Jan. 31, 2015) (noting that PayPal presently operates as a subsidiary of eBay).

<sup>150</sup> “Consumer” means natural person. §1005.2(e).

<sup>151</sup> § 1005.2(a)(1).

financial institution to debit or credit a consumer's *account*.”<sup>152</sup> Therefore, whether PayPal fits within the definition of a person “that issues an *access device* and agrees with the consumer to provide *electronic fund transfer service*” depends on whether the type of accounts it holds qualify as an *account* under Reg. E.<sup>153</sup> Thus, whether PayPal fits under either of Reg. E's possible definitional inclusions depends on whether the type of accounts held by PayPal qualify as an *account* under Reg. E.

It is unclear if PayPal accounts qualify as an account under Reg. E. Reg. E defines account as “*demand deposit* (checking) or savings accounts, or other consumer *asset account* . . . held directly or indirectly by a *financial institution*.”<sup>154</sup> First, it is unclear whether PayPal accounts qualify as a “demand deposit (checking) or savings account” under Reg. E. It is unclear whether regulators intend “demand deposit (checking)” accounts to only include traditional financial institution checking accounts or if the checking parenthetical was only an illustration. In the Electronic Funds Transfers Act (“EFTA”), Congress did not include the “(checking)” parenthetical after the term demand deposit, and deferred the right to further define the term to the CFPB.<sup>155</sup> Therefore, PayPal could argue that Reg. E's checking parenthetical is meant to foreclose inclusion of any other type of account but traditional checking accounts within the term demand deposit.

Additionally, PayPal could argue that its accounts are not demand deposit accounts under other regulatory definitions of demand deposit account.<sup>156</sup> Under Regulation D, the Federal Reserve described demand deposit accounts as having five characteristics: (1) no maturity; (2) payable on demand (or on less than seven days notice); (3) interest-bearing; (4) no limit on the number of withdrawals or transfer an account holder may make; and (5) no eligibility requirements.<sup>157</sup> PayPal account balances are not always payable on demand. While PayPal does allow the withdrawal of money from a PayPal account to a bank account by electronic transfer,<sup>158</sup> PayPal may limit withdrawals to \$500 per month depending on the degree to which you have “verif[ied] your account.”<sup>159</sup> Additionally, PayPal may

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<sup>152</sup> § 1005.3(b).

<sup>153</sup> § 1005.2(i).

<sup>154</sup> § 1005.2(b)(1).

<sup>155</sup> See 15 U.S.C. § 1693a(2) (including in the definition of “account” the phrase “as described in regulations of the [CFPB]”).

<sup>156</sup> Reserve Requirements of Depository Institutions, 12 C.F.R. § 204.2(b)(1) (2014).

<sup>157</sup> *Id.*

<sup>158</sup> *User Agreement*, *supra* note 137, at 6.1.

<sup>159</sup> *Id.* at 6.2. “‘**Verified Account**’ is an account status that reflects that PayPal is reasonably sure that an account holder has legal control of one or more of his or her Payment Methods.” *Id.* at 16.

delay the withdrawal of “large sums” while it performs a risk review.<sup>160</sup> Moreover, PayPal accounts are never interest bearing.<sup>161</sup> PayPal is entitled to 100% of the interest earned on the money in your account.<sup>162</sup> Furthermore, in order to be eligible for a PayPal account you must be 18 years old.<sup>163</sup>

By contrast, regulators could argue that PayPal accounts are demand deposit accounts under Regulation D. In most instances, a person may withdraw the funds in their PayPal account quickly.<sup>164</sup> The verification process doesn’t require a PayPal user to do anything.<sup>165</sup> Additionally, PayPal accounts have no maturity requirements and do not limit the number of withdrawals that may be made. Moreover, although PayPal requires its users to be 18 years of age or older, most traditional financial institution checking and savings accounts require depositors to be 18 or older as well.<sup>166</sup> In fact, many checking accounts have more onerous requirements—such as minimum balances—than do PayPal accounts.<sup>167</sup>

It is unclear whether a PayPal account qualifies as an *asset account* under Reg. E. The EFTA and Reg. E do not define the term asset account (although the official supplement does provide some specific inclusions—e.g., club accounts and retail repurchase agreements—but they are not helpful).<sup>168</sup> Certainly consumers who have balances in PayPal accounts would consider those balances an asset. However, it is unclear whether the CFPB intends this definition to be broadly inclusive or if it is meant as a narrower term of art. The term has not been defined by any accompanying regulation, statute, or in the common law. Investigation into the ordinary meaning of the term asset account leads to a murky result as well.<sup>169</sup>

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<sup>160</sup> *Id.* at 6.2.

<sup>161</sup> *Id.* at 5.1.

<sup>162</sup> *Id.*

<sup>163</sup> *Id.* at 2.1.

<sup>164</sup> *Id.* at 6.1.

<sup>165</sup> PayPal periodically deposits less than \$1 to the users bank account with a debit of the same amount soon afterwards after. This process verifies that the user truly has control of the account.

<sup>166</sup> The age of majority in the United States.

<sup>167</sup> See, e.g., *Compare Checking Accounts*, BANK AM., <https://www.bankofamerica.com/deposits/checking/checking-accounts.go> (last visited Mar. 10, 2015); *Compare Checking Accounts*, WELLS FARGO, <https://www.wellsfargo.com/checking/compare-accounts/> (last visited Mar. 10, 2015); *Checking Accounts*, CITIBANK, <https://online.citibank.com/US/JRS/pands/detail.do?ID=Checking> (last visited Mar. 10, 2015).

<sup>168</sup> 12 C.F.R. § 1005.2(b) (Supp. I 2014) Official Interpretation 2.

<sup>169</sup> It is not unreasonable to posit that the term “asset account” could currently include the type of account held by PayPal. *Businessdictionary.com* defines asset account as: “The net value held by a business of such things as liquid funds,

Nonetheless, assuming, *arguendo*, that a PayPal account qualifies as a demand deposit or asset account, it is still unclear whether it fits within the definition of account under Reg. E. The second part of the definition of the term *account* requires that the demand deposit, savings or asset account be “held directly or indirectly by a financial institution.”<sup>170</sup> Unfortunately, as we have examined, whether PayPal fits within the definition of *financial institution* depends on whether its accounts fit within the definition of *account*.<sup>171</sup> However, as we have just discovered, whether the accounts PayPal holds fit within the definition of *account* depends on whether PayPal fits within the definition of *financial institution*. Therefore, the definitions of *account* and *financial institution* are circular. Thus, it is unclear whether PayPal accounts qualify as an account under Reg. E.

In sum, it is unclear if PayPal, when processing EFTs from its own accounts, is regulated by Reg. E because of the insufficient specificity and circular language of Reg. E’s definitions. Reg. E applies to “any electronic fund transfer that authorizes a *financial institution* to debit or credit a consumer’s *account*.” First, it is unclear if PayPal qualifies as a financial institution under Reg. E. Whether PayPal qualifies as a *financial institution* under Reg. E depends on whether a PayPal account qualifies as an *account* under Reg. E. However, it is unclear whether a PayPal account qualifies as an account under Reg. E. This is because Reg. E fails to define the terms “demand deposit” and “asset account.” Furthermore, whether a PayPal account qualifies as an *account* under Reg. E also depends on whether the account is held by a *financial institution*. Thus, because of the insufficient specificity and circular language of Reg. E’s definitions it is unclear if PayPal, when processing EFTs from its own account, is regulated by Reg. E.

### *B. Congress & the CFPB Intend Reg. E to Regulate PayPal*

It is likely that Congress and the CFPB intend Reg. E to regulate PayPal. A finding that PayPal, when processing EFTs from its own accounts, is beyond the regulatory power of Reg. E would be at odds with the purpose and reasoning behind the creation of Reg. E and the EFTA. Additionally, such a finding would render a large portion of Reg. E’s language a nullity. Moreover, if the Federal Reserve or the CFPB had intended alternative payment services to be beyond the scope of Reg. E it

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investments, accounts receivable, unsold inventory, real estate, machinery and valuable intangibles.” *Asset Account*, BUSINESSDICTIONARY.COM, <http://www.businessdictionary.com/definition/asset-account.html> (last visited Mar. 10, 2015). However, it is also not unreasonable to posit that the type of account held by PayPal does *not* fall within this definition.

<sup>170</sup> § 1005.2(b).

<sup>171</sup> See *supra* text accompanying notes 149–53.

would have specifically excluded them. Further, alternative payment services are more akin to those that are included within Reg. E than those excluded. Thus, it is likely that Congress and the CFPB intend Reg. E to regulate PayPal.

A finding that PayPal, when processing EFTs from its own accounts, is beyond the regulatory power of Reg. E would be at conflict with the purpose of the EFTA and Reg. E. Both the EFTA and Reg. E state that their purpose is to establish the “basic rights, liabilities, and responsibilities of consumers who use electronic fund transfer . . . and of the financial institutions or other persons that offer these services” with the primary objective of protecting “individual consumers engaging in [EFTs].”<sup>172</sup> This purpose would seem to comprehend the inclusion of the millions of individuals who use PayPal and similar alternative payment services. A finding to the contrary would be in conflict with the purported objective of protecting consumers engaging in EFTs.

Additionally, a finding that PayPal, when processing EFTs from its own accounts, is beyond the regulatory power of Reg. E would be at odds with the reasons that the EFTA and Reg. E were created. The EFTA and Reg. E were created in response to a congressional finding that EFTs provide the “potential for substantial benefits to consumers” but that their “unique characteristics” made application of law, at that time, unclear.<sup>173</sup> If we find PayPal beyond the scope of Reg. E, we again find ourselves in an environment where application of law to EFT providers, such as PayPal (who provide substantial benefit to consumers), is unclear.

Moreover, such an interpretation would render a large portion of Reg. E’s language a nullity. That is, it would be impossible for any non-bank, saving association or credit union that holds its own accounts to fit within the category of a “*person* that directly or indirectly holds an *account* belonging to a *consumer*” or a person “that issues an *access device* and agrees with the consumer to provide *electronic fund transfer* services” because of the circular definitions of *account* and *financial institution*. Such an interpretation would exclude from regulation a larger number of EFT payment *services* than it includes.<sup>174</sup> Given the broad declarative statements in the purpose of the EFTA and Reg. E, this could not have be what the Federal Reserve or the CFPB intended.

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<sup>172</sup> 12 C.F.R. § 1005.1(b) (2013) (quoting 15 U.S.C. § 1693b (2012)) (declaring the purpose of the EFTA).

<sup>173</sup> 15 U.S.C. § 1693.

<sup>174</sup> See *supra* note 36 and accompanying text. Note the emphasis on the word “services.” This is meant to suggest that most payment services would fall outside of the regulation. However, the lion’s share of EFTs is facilitated through banks, savings associations, and credit unions, which are covered by the EFTA and Reg. E.

Furthermore, if the Federal Reserve or the CFPB had intended alternative payment services to be beyond the scope of Reg. E, it would have specifically excluded them. Reg. E does make specific exclusions for several types of payment methods including checks, checking guarantees, wire transfers, securities and commodities transfers, automatic transfers by account-holding institutions, telephone-initiated transfers, and preauthorized transfers made by small institutions.<sup>175</sup> Due to wide-spread familiarity with alternative payment services, it is unlikely that regulators were simply unaware of them.<sup>176</sup> However, because regulators did not specifically exclude alternative payment services, it is fair to assume they did not intend them to be beyond the scope of Reg. E.

PayPal could argue that the list of exclusions was not intended to be exhaustive and that PayPal services are more akin to those excluded than those included, but its argument would likely fail. The most analogous of the excluded payment services to alternative payment services are wire transfers.<sup>177</sup> Although both wire transfers and PayPal payments are both low-cost electronic means of making a payment, they are distinct in several important ways.<sup>178</sup> Wire transfers involve large sums of money, whereas most PayPal transactions involve small sums.<sup>179</sup> Most importantly, wire transfers are primarily made in the furtherance of business ventures, whereas PayPal payments can only be made for personal or household uses.<sup>180</sup> The EFTA and Reg. E make clear in both their purpose and definitions that their protections are meant only to be applicable to

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<sup>175</sup> 12 C.F.R. § 1005.3(c) (2013). Also, it is important to note that PayPal would likely fit within the exclusion for small institutions if the theft was by preauthorized transfers. *See* § 1005.3(c)(7) (granting this exclusion).

<sup>176</sup> PayPal has 143 million active accounts and processed 27 billion dollars of payments in 2013. Therefore, it is highly unlikely that expert financial regulators at the CFPB have not heard of the PayPal and its kin. *See supra* note 19 and accompanying text.

<sup>177</sup> Wire transfers are a high speed, low cost method of sending and receiving funds. They are used primarily in businesses dealings involving large sums of money. *See* U.C.C. § 4A Prefatory Note (2013).

<sup>178</sup> In fact, the Uniform Commercial Code, in explaining the need for a special section covering wire transfers, notes that there “is some resemblance between payments made by wire transfers and payments made by other means such as . . . credit cards and electronically-based consumer payments, but there are also many differences.” *Id.*

<sup>179</sup> *See id.* (describing wire transfers); *Love at First Site*, PAYPAL, <https://www.paypal.com/webapps/mpp/ent-online-attract-shoppers> (last visited Mar. 10, 2015) (stating that the average PayPal user transfers only \$4,214 per year).

<sup>180</sup> Users can purchase a special type of PayPal account specifically for business transactions. *See Businesses Sell More with PayPal*, PAYPAL, <https://www.paypal.com/webapps/mpp/merchant> (last visited Mar. 10, 2015).

consumers for non-business purposes.<sup>181</sup> Additionally, the other payment services that are excluded—including telephone-initiated transfers and checks—are likely excluded due to their non-electronic nature, an element that PayPal does not share.

Alternative payment services are more akin to those that are included within Reg. E than those excluded. PayPal payments are typically made in small sums and for non-business purposes in the same way that debit and credit cards are.<sup>182</sup> Additionally, PayPal payments are facilitated by deposits of money into accounts administered by a third party, with no meaningful distinction as to whether that third party is PayPal or a bank.<sup>183</sup> Moreover, PayPal payments and debit or credit card payment are accepted by merchants in largely the same fashion. In fact, PayPal payments are now even accepted at many retailer POS terminals.<sup>184</sup>

Further, PayPal accounts share a striking similarity to Reg. E's description of gift cards and payroll card accounts. As with gift cards and payroll card accounts, PayPal accounts are used primarily for personal, family or household purposes and are used to acquire goods or services from merchants. The only distinction between making a purchase with a PayPal account or a gift card is that a PayPal account can be used to purchase goods or services from a variety of retailers, whereas a gift card can only be redeemed by the merchants who issue them. This distinction should be of little consequence. All other forms of regulated EFTs, including debit or credit, permit a consumer to make purchases from a variety of retailers. Additionally, the only distinction between making a purchase with a PayPal account or a payroll card account is the source of the funds. This distinction should be of little consequence as well. As with debit or credit cards, no other source of permissible EFT considers where the funds originated. Thus, alternative payment services are more akin to those that fit comfortably within Reg. E.

In sum, a finding that PayPal, when processing EFTs from its own accounts, is beyond the regulatory power of Reg. E would be at odds with the purpose and reasoning behind the creation of Reg. E and the EFTA. Additionally, such a finding would render a large portion of Reg. E's language a nullity. Moreover, if the Federal Reserve or the CFPB had intended alternative payment services to be beyond the scope of Reg. E, it

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<sup>181</sup> 15 U.S.C. § 1693 (2012); 12 C.F.R. § 1005.1(b) (2013).

<sup>182</sup> See *PAYPAL*, *supra* note 180.

<sup>183</sup> PayPal could argue that its accounts do not bear interest in contrast to financial institution accounts. However, given the negligible prevailing interest rates the court may find this distinction trivial.

<sup>184</sup> See *Store Locator*, *PAYPAL*, <https://www.paypal.com/us/webapps/mpp/store-locator> (last visited Mar. 10, 2015) (listing merchants such as Home Depot, Office Depot and Dollar General as all accepting PayPal).



would have specifically excluded them. Further, alternative payment services are more akin to those that are included within Reg. E than those excluded. Thus, it is likely that Congress and the CFPB intend Reg. E to regulate PayPal.

### *C. Reg. E and Alternative Payment Services: The Prescription*

In order to ensure that Reg. E applies to all of the functions of PayPal, the CFPB must clarify its language. First, the CFPB should remove the phrase *held by a financial institution* from the definition of “account.”<sup>185</sup> This clarification would eliminate the circular aspect of the terms “financial institution” and “account.” Next the CFPB should provide a definition for the term *demand deposit* or *asset account*. In so doing, the CFPB should make clear that definitions include the type of accounts held by alternative payment services like PayPal.<sup>186</sup> These definitions would ensure that the type of account held by PayPal is properly recognized by the regulation.

This prescription would not fundamentally change the nature of Reg. E or the regulatory requirements with which alternative payment services must adhere. First, this change would bring Reg. E in line with its purported purpose of “protecting individual consumers engage[ed] in [EFTs],” as a great number of consumers are currently engaging in EFTs with alternative payment services.<sup>187</sup> Additionally, many leading alternative payment service companies already purport to meet or exceed the requirements of Reg. E.<sup>188</sup> Furthermore, there is precedent for such a change; in 2009, Reg. E was expanded to include prepaid gift cards and payroll card accounts.<sup>189</sup> Thus, this prescription would not fundamentally change the nature of Reg. E.

### *D. The CFPB Has the Power to Regulate PayPal Under Regulation E*

The EFTA gives the CFPB the power to regulate PayPal under Reg. E. The EFTA can be read as granting the CFPB broad discretion to make changes to the regulation such as the one proposed by this Issue Brief. Section 1693b(a)(1) of the EFTA grants the CFPB the authority to “prescribe rules to carry out the purposes of” the EFTA.<sup>190</sup> Additionally,

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<sup>185</sup> 12 C.F.R. § 1005.2(b).

<sup>186</sup> Additionally, it should define these accounts with sufficient specificity to prevent the removal of the phrase “held by a financial institution” from expanding the scope of the regulation beyond what was originally contemplated.

<sup>187</sup> § 1005.1(b).

<sup>188</sup> See, e.g., *User Agreement*, *supra* note 137, at 12; *Amazon Payments, Inc. Customer Agreement*, Amazon 10 <https://payments.amazon.com/sdui/sdui/about?useragreement> (last visited Mar. 10, 2015).

<sup>189</sup> See *supra* text accompanying note 114–116.

<sup>190</sup> 15 U.S.C. § 1693b(a)(1) (2012).

Section 1693b(c) of the EFTA grants the CFPB the authority to prescribe “classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of electronic fund transfer . . . as in the judgment of the [CFPB] are necessary and proper to effectuate the purpose of” the EFTA.<sup>191</sup> These two grants of authority give the CFPB the power to prescribe new definitions as well as clarify existing definitions to allow for the regulation of any alternative payment services under Reg. E that the CFPB sees fit. As noted earlier, such a classification would be well within the purpose of the EFTA.<sup>192</sup>

Moreover, the definition of the term “account” in the EFTA is written to give the CFPB discretion to interpret its meaning.<sup>193</sup> The EFTA defines *account* as “a demand deposit, savings deposit or other asset account as described in regulations of the [CFPB].”<sup>194</sup> In so doing, Congress essentially says an *account* can either be A, B, C, or whatever the CFPB says it is!<sup>195</sup> Therefore, the CFPB’s clarification of Reg. E’s definition of account would be quite comfortably within the CFPB’s grant of authority. Furthermore, the EFTA goes as far as announcing that “[n]o provision of [the EFTA] may be construed as altering, limiting, or otherwise affecting the deference that a court afford to . . . the [CFPB] in making determinations regarding the meaning or interpretation of any provision of [the EFTA].”<sup>196</sup> This can be read to foreclose any remaining arguments that the CFPB lacks the authority to regulate PayPal under Reg. E. Thus, the EFTA gives the CFPB the power to regulate PayPal under Reg. E.

## CONCLUSION

In light of the growth of data breaches in both occurrence and scale, it is more important than ever for consumers to be aware of the protections afforded to them under the law regarding EFTs and alternative payment

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<sup>191</sup> § 1693b(c).

<sup>192</sup> *See supra* text accompanying note 172.

<sup>193</sup> § 1693a(2).

<sup>194</sup> *Id.* However, an opponent of the inclusion of alternative payment services may also argue that this discretion was used when Reg. E included the term “checking” within a parenthetical accompanying the term demand deposit account, and that, therefore, alternative payment service should not be included within the definition of “demand deposit.”

<sup>195</sup> PayPal could argue that the enumerated definitions included within the EFTA so clearly do not include alternative payment service account as to abrogate the discretion it purports to give to the CFPB. However, this argument fails because, as is discussed above, the definitions of deposit demand and asset account have not been shown to materially differ from the accounts of alternative payment services. *See supra* text accompany notes 156–169.

<sup>196</sup> § 1693b(e).

services. Additionally, it is important that agencies like the CFPB, charged with protection of unsuspecting and often defenseless consumers, are carefully monitoring these protections to ensure they keep pace with the technological evolution of the payment services they regulate. Alternative payment services, such as PayPal, are currently conducting an enormous number of payments and providing an extremely beneficial service in the era of e-commerce.

However, the EFTA and Reg. E, as currently written, do not adequately protect consumers using these alternative payment services. The EFTA and Reg. E provide insufficient specificity and circular language for key definitions, including the terms “financial institution” and “account.” These deficiencies could leave consumers engaged with alternative payment services in the unique position of facing unlimited liability for losses resulting from unauthorized EFTs from their alternative payment service accounts. Thus, in order to ensure that Reg. E is written broadly enough to apply to all the functions of PayPal, the CFPB should remove the phrase *held by a financial institution* from the definition of “account” and provide a definition for the terms “demand deposit” and “asset account.” Furthermore, the CFPB has the power to regulate PayPal under Reg. E, as the EFTA grants the CFPB broad discretion to make changes to the regulation like the one proposed here. This change in language would not fundamentally change the nature of Reg. E but would provide a necessary shield for consumers.