

November 19, 2004

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551  
[regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Re: Docket No. R-1210 - Proposed Regulation E

Dear Ms. Johnson:

BITS and The Financial Services Roundtable (“Roundtable”) appreciate the opportunity to comment on the proposal by the Federal Reserve Board (“Board”) to amend provisions of Regulation E relating to electronic check conversion services. Additionally, the proposal seeks comment on extending Regulation E to cover payroll card accounts established directly or indirectly by an employer on behalf of a consumer for the purpose of providing salary, wages, or other employee compensation on a recurring basis. The proposal also suggests modified language relating to preauthorized transfers, additional electronic check conversion issues, error resolution, and other matters.

BITS and the Roundtable are national associations that represent 100 of the largest integrated, diversified financial services companies providing banking, insurance, and investment products and services to American consumers. BITS and the Roundtable fully support the Board’s actions to regularly reevaluate components of Regulation E in response to changing market circumstances. While we believe that a number of the Board’s current proposals are appropriate, some proposals seek to solve problems already addressed or may result in significant unintended consequences that require substantially more analysis before codification.

### **Electronic Check Conversion (ECK)**

The Proposed Rule would modify Section 205.3(a) to cause all parties, whether persons, merchants, or other payees engaged in electronic check conversion transactions, to be subject to Regulation E for the limited purpose of obtaining authorizations for those conversions. Under the proposed rule, generally a notice would have to be provided for each transaction. For Accounts Receivable Conversion (“ARC”) transactions, obtaining a single authorization from a consumer holding an account would be sufficient to convert multiple checks submitted as payment after receiving an invoice during a single billing cycle. Also, Section 205.3(b)(2)(iii) would require persons initiating an Electronic Fund Transfer (“EFT”) using information from a consumer’s check to provide notice that, when the transaction is processed as an electronic funds transfer, funds may be debited from the consumer’s account quickly and that the consumer’s check will not be returned by the consumer’s financial institution (except that this additional notice would not be required of a merchant that returns the check at the point-of-sale).

In extending Regulation E to merchants and other non-bank payees for the sole purpose of obtaining authorizations for electronic check conversion transactions, the Board noted that it has received complaints about the uniformity, visibility, and adequacy of consumer notices. Indeed, after the introduction of widespread Point Of Purchase (“POP”) and ARC services, financial institutions experienced significantly higher rates of exception circumstances than we see today. These rates occasionally approached or exceeded those of the transaction sets with which consumers have been familiar for decades, pre-authorized, recurring debits (“PPDs”). The industry acted quickly on a range of fronts to better educate customers about the changing nature of the payments environment, and believes that through an ongoing process it is being successful in informing all stakeholders about the mechanics of new electronic check conversion services. The success of this education process has been documented in the steady improvement in unauthorized return patterns for both the ARC and POP transaction sets. NACHA’s third quarter 2004 statistics on ARC and POP (the most recent available) indicate that unauthorized return rates on these items are continuing to trend positively, demonstrating that early marketplace issues relating to these transaction types have been resolved. Additionally, our members have reported declining POP and ARC customer service related call rates. BITS and the Roundtable believe that the fundamental reason for suggesting the extension of notice requirements has been resolved and that the extension will not at this time serve a material purpose.

Nevertheless, if the Board moves forward with the revised notice language, it should carefully consider several additional issues.

The Board is seeking commentary on whether merchants or other payees should be required to obtain the customer’s written signed authorization in order to convert checks received at the point of sale. As the Board notes in its Summary of Proposed Regulations, NACHA already requires merchants to obtain a written authorization from the consumer for electronic check conversion transactions from a consumer’s account. We believe that inclusion of such a requirement in Regulation E is unnecessary, and in fact may limit the industry’s flexibility to deal with changing market circumstances in the future.

In Section 205.3(b)(2)(iii) the Board proposes to require entities initiating an EFT using information from a customer’s check to provide notice that funds may be debited from the consumer’s account quickly when a transaction is processed as an EFT. BITS and the Roundtable believe that this language could be misleading and inaccurate. There are many circumstances today, and there will be more in the future as Check 21-related transaction processes grow, in which paper checks will clear as quickly, or even more quickly, than electronic transactions. We recommend that this language be omitted.

The proposed regulation would require notice at the point of sale that, unless a check was returned to the consumer at the time of transaction initiation, the consumer’s check will not be returned by the consumer’s financial institution. As the Board is aware, a growing majority of consumers (about two-thirds) do not receive their original checks in their statements today, and Check 21 will further reduce the number of *original* checks returned in consumer statements. A notice focusing on the return of the original check items will be of decreasing significance to more and more consumers.

The Proposal solicits comment on whether notices stating that a consumer’s check used to initiate an ECK *may* be processed as a paper transaction must specify the circumstances in which the check would be processed as a paper transaction. We believe that merchants and payees should be able to use their discretion in processing checks in the most efficient manner, that

specific circumstances governing how best to process a check are subject to frequent change, and that disclosing the specific circumstances would provide no significant benefit to consumers.

Under the proposed rule, generally a notice would have to be provided for each transaction where an electronic check conversion is contemplated. However, proposed comment 3(b)(2)-4 would provide guidance acknowledging that a single authorization is sufficient to convert multiple transactions in a single billing cycle if there are multiple payees or payments in a transaction being converted. We believe that is a useful clarification, and support its inclusion.

There are other circumstances, however, where we believe the contemplated notice requirement is unnecessarily burdensome. For example, the repeat notice requirement creates issues for financial institutions dealing with mortgage payments when customers use a coupon on a monthly basis. As proposed, the suggested language would require a financial institution to send a notice each month to every customer with a coupon book, at significant unnecessary expense. We suggest that the Board include commentary permitting a one time notice for use with coupon books, perhaps in the form of a disclosure that could be pasted to the front or rear cover of the book itself. This kind of solution would recognize the reality that the entire coupon book itself is, in effect, a single statement.

BITS and the Roundtable support the proposal that electronic debits to collect NSF/return check fees would be authorized if the consumer is given notice that the fee will be collected electronically and the consumer then proceeds with the transaction.

### **Payroll Card Provisions**

We support the Board's proposal to cover Payroll Card Accounts under Regulation E.

The Proposal solicits comment on whether Regulation E coverage should be determined based on whether the funds in the payroll account are considered eligible deposits by the FDIC. We do not believe that Regulation E coverage should be determined based on whether the funds in a payroll card account are considered eligible deposits by the FDIC

As proposed, Regulation E would require that a periodic statement be provided for each monthly cycle in which an electronic fund transfer occurs, or at least quarterly if there are no electronic fund transfers. We believe that Regulation E should permit alternatives to periodic statements for payroll card accounts, such as making account balance and transaction information available through automated telephone inquiry, ATMs, and the Internet. A requirement for periodic statements would add to the costs associated with payroll card accounts, making them a less attractive product for consumers, employers and banks. A paper statement mailed to the account holder is not necessarily the most effective method for providing information to payroll card holders, many of whom are transient and change their residence on a frequent basis. A current provision of Regulation E for government benefit accounts permits alternatives to the periodic statement, if information is made available through telephone inquiry, at ATMs, or upon written or oral request. BITS and the Roundtable believe that real time statement alternatives are particularly appropriate to a customer segment that may be unfamiliar with account reconciliation of conventional statements, which will rarely if ever provide a truly up to date transaction record.

## **Error Resolution Procedures and the Consumer's Right to Stop Payments**

Noting channel specific inconsistencies in an institution's error resolution responsibilities (for example, ACH *versus* real time debit accomplished check conversions), the proposal solicits comments about whether there are circumstances in which the so-called "four walls" rule should not apply. We believe the proposal, as written, adds significant ambiguity. In light of the increased variety of EFT transaction types, information relevant to an assertion of error is likely to be outside the payment instructions but within the "four walls" of the institution's records. To facilitate a financial institution's compliance with this requirement, we would prefer that the final regulation state that the requirement be for a "reasonable" investigation, combined with specific examples of appropriate steps.

BITS and the Roundtable support revised commentary that would stipulate that financial institutions need not comply with error resolution requirements in instances where a consumer does not provide notice of error on a timely basis (*i.e.*, within sixty days of date that periodic statement was mailed), as long as the institution has complied with the terms of Section 205.6, *Liability of Consumer for Unauthorized Transfers*.

Revised commentary governing credit card or debit card numbers provided by telephone or on-line for recurring transfers would protect merchants in those instances where the card type specified by the consumer is incorrect (such as when a consumer indicates a credit card, but the card is actually a debit card, or *vice versa*), as long as merchant has asked the consumer to indicate the type of card. The provision provides important protection in those cases where the merchant does not have real time access to Bank Identification Number ("BIN") tables that might be utilized to check the accuracy of the consumer's statement and should be adopted.

Proposed comment 10(c)-3 would address procedures for stopping recurring payments in systems involving real-time processing, such as debit card systems. BITS and the Roundtable support the provision to state that financial institutions may use a third party to block transfers, as long as such payments are in fact stopped. This proposal recognizes the mechanics of real time debit systems and clarifies a process that properly reflects the intent of the rule.

### **Unsolicited Card Provisions**

We support revised commentary that would require that any unsolicited additional cards or other access devices issued as renewal or replacement devices be issued in an "unvalidated" status.

### **ATM Disclosure Provisions**

BITS and the Roundtable support proposed changes to comment 205.16(b)(1)-1 that would clarify that disclosures at ATM machines may indicate that "A Fee *May* be Imposed" rather than "A Fee *Will* be Imposed" if there are, in fact, circumstances in which a fee would not be charged. The proposal recognizes the increasing number of circumstances in which ATM operators have entered into contractual arrangements with multiple issuers to eliminate fees for certain transaction types.

## **Transfer Provisions**

The Board has correctly noted in existing commentary that tape recorded telephone conversations authorizing transfers are not sufficient to constitute an authorization to transfer funds and may well be inconsistent with the E-Sign Act. The Board proposes to withdraw that commentary. BITS and the Roundtable generally support this action, but are concerned about the resulting ambiguity that may result from the absence of clear interpretation of the E-Sign Act as it pertains to telephone authorizations. We believe that this is a material issue that requires immediate attention.

BITS and the Roundtable support the addition of proposed comment 10(d)(2)-2, which would provide that a financial institution need not provide the consumer the option of receiving notice before providing a customer a range of varying amounts of transfers of funds to an account of the same consumer held at another financial institution.

## **Model Clauses**

Financial institutions should not be required to amend initial disclosures. Most banks have considered electronic checks to be electronic funds transfers since the Commentary to Regulation E was revised in 2001, and those banks include electronic checks in their Regulation E initial disclosures. Consumer periodic statements contain the proper description of the transaction as required by Section 205.9(b); consumer disputes concerning ECKs are managed under the process described in Section 205.11. BITS and the Roundtable do not believe that financial institutions should be required to amend initial disclosures to include additional detail that is applicable only to electronic check transactions, which are already covered by the Commentary to Regulation E. The changes proposed in Section 205.7 and Appendix A would require financial institutions to destroy their existing stock of preprinted disclosures and to notify existing customers of a change of terms. The cost of reprinting and of mailing these disclosures would be significant and would far exceed any consumer benefit of receiving a notice that explains a process that financial institutions have been following for several years. Therefore, we urge the Board to withdraw the proposed revision to Section 205.7 and the model clauses for initial disclosures in Appendix A.

## **Adoption Timeframes**

The Board has solicited comment on whether six months following adoption of the revised rules is sufficient time for mandatory compliance. BITS and the Roundtable firmly believe that entities subject to the provisions should be given twelve months following adoption to comply. This time period is necessary for internal training purposes and to permit any necessary changes to be incorporated into disclosures and communicated to consumers in regularly scheduled mailings.

If you have any further questions or comments on this matter, please do not hesitate to contact either of us at (202) 289-4322.

Sincerely,

BITS

The Financial Services Roundtable