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Ms. Jennifer L. Johnson, Secretary
Board of Governors
Federal Reserve System
20th and Constitution Ave., N.W.
Washington, DC 20551

By email: regs.comments@federalreserve.gov
Or by fax: 202-452-3819

Re: Docket No. R-1210

Dear Ms. Johnson,

These comments are submitted by Consumers Union, the Consumer Federation of America, the National Consumer Law Center on behalf of its low income clients, and U.S. PIRG. This comment letter addresses aspects of the proposed rule in Docket No. R-1210 other than the added definition of a payroll card account in section 205.2(b). That topic is extensively addressed in a separate comment letter. Certain broader policy issues related to Regulation E will be addressed in another letter to be prepared by the National Consumer Law Center and joined by many of the groups joining in this letter.

Section 205.3: Coverage

We support the proposal to cover under the EFTA the merchant or check payee who engages in electronic check conversion. However, the coverage for the merchant or check payee who converts the check must be in addition to, and not a reduction of, coverage of the bank or other financial institution on whom the check is written. It is useful to treat the check converter, if possible, as an agent of the bank of first deposit, because such responsibility on the part of the bank may induce more oversight by the bank of the practices of entities that create payment orders through electronic check conversion. However, it is also essential to cover the check converter directly under the EFTA, since that is the party who may attempt to debit not only the face amount of the check, but also fees associated with that check. The manner of authorization for those fees is discussed below; the point here is that persons who assess these fees must be covered by the requirement that such fees be authorized by the consumer.

Section 205.3(b)(2): EFT using information from a check

We support the approach of the proposed rule to expressly state that Regulation E covers an EFT arising from electronic check conversion. While this has been the interpretation of the Board, it is helpful to state it more directly in Regulation E. We are also pleased to see the plain statements that the consumer must authorize all transfers, and that the EFT "from a check" rules apply whether the initiating document is a check, draft, or similar paper document. We note, however, that nothing in the Federal Reserve Board's draft rule would require that consumers be told that they

have the option to say "no" to electronic check conversion. Since consumers have this right under the NACHA rules, shouldn't they be told about it? When consumers learn that check conversion involves destroying the original check, they often ask "Can I stop this practice?" Since consumers do have a right to stop the practice under the NACHA rules, the notice should inform consumers of that right.

Comment 205.3(b)-3: Authorization required to debit a check-related fee

We strongly support the concept in the new comment 3 to section 205.3(b) that an electronic debit from a consumer's account to pay for a returned check fee (or a returned EFT fee) must be authorized by the consumer. However, we oppose the interpretation, stated elsewhere, that a mere notice plus action would be sufficient to authorize debiting of these fees. We respectfully suggest that the comments be augmented to expressly state that the authorization requirement is not satisfied by notice plus check-writing behavior. When a consumer writes a check, he or she can reasonably expect that funds in the face amount of the check will be removed from the consumer's account, indeed, that is the very purpose of writing a check. However, the consumer reasonably anticipates, and impliedly authorizes, a withdrawal from the account in the face amount of the check, not in some higher amount. Prior, written authorization is essential if any other funds are to be removed from the consumer's account, such as funds for payment of a merchant-imposed check return fee. The authorizing document should state the amount of the fee and when it may be charged. In addition, the authorization should be good for just one fee per authorization, not for multiple impositions of fees stemming from a single check. At a minimum, the comments should state that the form of authorization for a one-time EFT described in comment 1 to section 205.3(b)(2) (which is notice plus action) is not a sufficient form of authorization for the debit of any amount in excess of the face amount of the check.

Requiring merchants and other check converters who wish to collect a fee related to an item to get a real authorization for the specific debit, including the amount and purpose of that debit, will help to police the market. Consumers who must agree to an additional debit in the event the payment is not honored might be induced to exercise more care in ascertaining their balances before making a payment. Consumers who are asked in person at a retail establishment to authorize this fee might decide to shop elsewhere. Merchants and billers who have to tell all their customers that each is giving the company access to the consumer's deposit account for an amount greater than the face amount of the check may keep the fee down as a way to avoid harm to customer goodwill. When only those consumers who experience a payment problem have to be told of the fee, the marketplace policing function of real customer authorization will be minimized.

Comment 205.3(c)-1: Exclusions from coverage

The change here does not address the basic irrationality of treating electronically converted checks as EFTs, but electronically re-presented checks as checks. The theory which treats an electronic check conversion transaction as not initiated by check could be applied to electronic re-presentment as an EFT of an original check. Thus at a minimum, this comment could say that when the consumer is notified that the check may be electronically re-presented, in the same manner in which the consumer is notified that the check may be electronically converted, then the re-presentment is an EFT (under the same theory of notice plus checkwriting that underlies electronic check conversion). This notice could be given by financial institutions to deposit account holders,

thereby creating increased parity between types of electronically processed items by bringing electronic re-presentments which are preceded by notice under the EFTA.

Comment 205.3(c)(1)(I): Any "notice plus action" authorization should not apply to debits beyond the face amount of the check

The Board solicits comment on whether a signed written authorization should be required for electronic check conversion at the point of sale. As a general matter, we believe that no person should be permitted to debit funds from a consumer's account without an express prior authorization from the consumer for that specific debit, in a stated amount. In general, we believe that a signed written authorization is always preferable to a simple notice plus action. For this reason, we seek a more explicit requirement for a signed written authorization for any debit from the consumer's account *other than* the payment of the amount which is reflected on the face of the check. However, we do not believe that a written preauthorization requirement for the conversion of the check itself (as opposed to for fees associated with the check) will serve the consumer interest.

The reason is this: The consumer will have better, more complete, more easily accessible consumer rights if his or her paper check is electronically converted (and thus covered by the EFTA) than if that same check is imaged under Check 21. Both of these choices are available to the payee (acting as the agent of its bank, if acting under Check 21). Since Check 21 imaging requires no notice to or consent of the consumer, a strong authorization requirement for electronic check conversion could have the perverse effect of moving merchants toward Check 21 imaging and away from electronic check conversion. This set of incentives would be contrary to the consumer's interests because the EFTA-conferred consumer rights in the event of error are stronger than the Check 21 rights. Consumers whose checks are converted to an ACH payment have error resolution and a ten business day recredit rights, without a dollar cap, under the EFTA. Under Check 21, by contrast, only those consumers who have been provided with a substitute check have a ten business day recredit right under the implementing regulations, and only up to the first $2,500 of the check amount. The reason that we do not favor a strong authorization requirement as a condition of electronic check conversion is that it might discourage use of electronic check conversion in favor of a process that provides inferior consumer rights, Check 21 imaging.

Notice plus action is not an effective form of either notice or authorization. Evidence collected by Consumers Union in another context illustrates the weaknesses of a "notice plus check use" to actually inform consumers or to elicit true consent. When Consumers Union posted an online petition on Check 21, over 18,000 consumers joined that petition in just two months. Although those consumers signed the petition before Check 21's effective date, a number of them added comments to the petition stating, in effect, "My bank is already doing this," or "This happened to me." These consumers went on to describe not receiving their original checks back in circumstances that sound like electronic check conversion.

For example, one consumer said:

> I did receive electronic notice of the change after the first implementation of the Check 21: The credit card payment to [named large bank-issued credit card] made by check was converted without clear explanation on the bank statement. The notice did indicate a later date of implementation. I do not appreciate this form of implementation without my say!...

Others said:

> I have already been stung by credit card companies/financial institutions processing my payments in this manner. I discovered that in at least one case [name of large bank] if you CALL customer service and complain, they will go back to normal processing and not destroy your check. I had to threaten to take my business elsewhere however...
>
> I have already experienced this twice. Thank [goodness] I had the funds in my account.
>
> I have recently had problems with my bank concerning the very same subject. I am considering changing banks unless I get some serious changes with my account.

Clearly, these consumers had not yet been effectively educated about electronic check conversion. The material about a then-pending change, that of Check 21, was the first explanation that they had noticed about why some original checks were not being returned to them.

Section 205.3(b)(2)(iii): Notice by converter, and Section 205.7: Notice by financial institutions

We support the requirement in section 205.3(b)(2)(iii) that the person who initiates the transfer provide notice to the consumer that the payment will clear quickly and that the consumer's financial institution will not return the original check.

The model clause for initial disclosures by a financial institution, form A-2, does not include some information that the model clause for a merchant/converter includes: that the check will clear more quickly and will not be returned to the consumer as a check. The initial disclosures by the financial institution should be required to include this information. Such a notice should tell account holders: "When you write a check, the funds may leave your account very quickly. One way this can occur is when the person you give the check to converts your check into an electronic payment order. We will then process that information as an electronic payment from your account. The payment may appear on your statement in a location different from where we show paid checks. If your check is converted to an electronic payment, you won't get the check back."

Another possibility would be to place the financial institution notice on each statement that includes a check-initiated EFT. The statement might say: "Some of the companies you paid by check electronically converted your check to an electronic payment. This causes the payment to be made promptly, and it means that your check is never given to the financial institution. Instead, the company that converts your check to an electronic payment must destroy the original check. These payments appear on your statement under the category ["ACH" or other relevant label, per financial institution's statement practices.]" The deposit account statement is the place where consumers may look to try to understand how funds were removed from their accounts, making an explanation on a deposit account statement a powerful opportunity to educate consumers about this method of processing payments.

Some of the common questions consumer groups receive from consumers about electronic check conversion are: "Where is my paper check?" and "Who allowed the merchant to destroy my original check?" Additional disclosure from both check converters and financial institutions will help to answer these questions.

Comment 205.5(a)-1 and section 205.5(b): Unsolicited issuance of access devices and the one-for -one rule

We believe that the Federal Reserve Board should reconsider both this proposed change and the underlying policy in the existing regulation on the issuance of access devices not requested by the customer. The stunning growth in identity theft makes unrequested access devices a bigger issue for consumers than it may have been when this part of Regulation E was first adopted. We oppose on principle any weakening of the one-for-one rule. Given the sophistication of identity thieves, the requirement in the existing rule that unsolicited devices be sent in a form that requires activation does not eliminate the risk. Sending multiple unsolicited devices to replace a single device may also create new problems. If this second device is sent at a different time than the first device, the consumer might not even know if it was waylaid or stolen before delivery, since the consumer would not be expecting a second replacement device. If the multiple devices were sent in the same envelope, one might be discarded unnoticed, yet be activated by the phone call that activates the main replacement device.

Our policy concerns with the rule on unsolicited issuance of access devices are rooted in concerns about practices permitted by the current exceptions to the rule. We urge the Federal Reserve Board to reevaluate this part of the proposed rule, rather than modifying it to permit multiple unsolicited access devices, even when the conditions for unrequested devices are met.

Section 205.7 Initial disclosures

We support the approach of the proposed change in section 205.7 to move to Regulation E the general rules requiring disclosure and the supporting commentary identifying electronic check conversion transactions as a type of EFT service that must be included in the disclosures. As discussed above, the disclosures made by a financial institution should include practical information for consumers such as the increased speed of payment clearing and the disposition of the original check.

The model clauses on liability and error resolution also must refer to time periods outside of the EFTA in order to avoid misleading consumers. The model disclosures quite accurately state the 60 day time period to report a problem with an electronically converted check. However, that statement may lead consumers to believe that imaged-processed checks, which the ordinary consumer may think of as a form of electronic processing, also are subject to a 60 day time period to report. Since the time period to report a check problem under the Uniform Commercial Code or under Check 21, as opposed to an electronic check conversion problem, is different and frequently shorter, the reference to 60 days could be misleading. Consumers are likely to confuse the electronic imaging under Check 21 with electronic check conversion, indeed, there is evidence that they are already doing so. For this reason, a notice describing the 60 day time to exercise the EFTA right must also tell the consumer that there are other, shorter time periods that apply to checks processed other than by electronic check conversion, such as by check imaging, which is also an electronic form of processing.

It is difficult to determine what time period should be included in any added reference to non-EFTA time periods in notices describing EFTA error resolution rights. Under Check 21, the reporting time

is 40 days if seeking expedited recredit, but longer when expedited recredit is not sought. If a UCC right is at stake, and no substitute check was provided, then under the UCC, there may be a statutory one year reporting time, but that time may have been shortened by contract, even to a time period shorter than the 40 days under Check 21. At minimum, the notice should say: "Other forms of electronic check processing have other time periods for you to act. Your time period to report a problem may be shorter if the error concerns the processing of a check which was not electronically converted. Report all problems to your financial institution as soon as you discover them."

Appendix A-2: Model clauses for initial disclosures

This is the first of several model clauses that, while accurate with respect to the EFTA, could create a misperception that 60 days is always the time period for action by the consumer. Because that time period may be shorter under Check 21, or under a time period provided by agreement as contemplated by the Uniform Commercial Code, a wholly accurate statement about the relevant EFTA time period may still mislead. We suggest an addition along the lines described in the prior paragraph of this letter.

In addition, the revised model clauses on consumer liability continues to use the phrases "[card] [code]" to describe what has been lost or stolen. The term "code" is unlikely to be as well understood as "PIN" or even "access code." This notice, along with other notices, should be subject to a complete review for readability and understandability. Despite these concerns, we are pleased to see that the model consumer liability clause will be augmented with a reference to the circumstance in which someone makes a transfer using information from a check without the permission of the consumer. We also find helpful the express addition of a description of electronic check conversion to the list of transfer types.

Appendxi A-3: Model Forms for error resolution notice

This first issue raised by this model forms occurs both in the new language of (b) and in the pre-existing language of (a). Both paragraphs state that the institution "will correct any error promptly." The use of the term "will" suggests a promise on the part of the financial institution, rather than a legal obligation of the institution. The model clauses should tell consumers that the financial institution "must correct any error within 10 business days." We strongly believe that consumers should be told when they have a right to action by the financial institution. The word "must" communicates this.

We are in strong support of the concept of adding a model notice similar to the language in paragraph (b) of the form. However, we believe that all notices giving the EFTA 60 day time period must also warn consumers that a shorter time period may apply for checks which are electronically processed as checks, rather than as EFTs. For example, an addition might read: "Other forms of electronic check processing have other time periods for you to act. Your time period to report a problem may be shorter if the error concerns the processing of a check which was not electronically converted. Report all problems to your financial institution as soon as you discover them."

Appendix A-6, Model clauses for authorizing one-time electronic fund transfer using information from a check

We support the aspects of this notice which inform consumers both that the check will clear quickly, and that the consumer will not receive back the check. The first item of information may help consumers avoid or minimize costly NSF check fees, the expense associated with an overdraft plan, or a costly "bounce loan" fee. The second item of information responds to an issue that has been a source of confusion for consumers.

We also strongly support telling the consumer in the model notice if a fee will be collected through the account, however, we suggest making this more explicit by rewording the final phrase in (a) to read: "and collect that amount directly from your account through an electronic fund transfer from your account" or and collect that amount by taking it directly out of your account through an electronic fund transfer.". However, we also strongly suggest that the final language of the regulation and commentary state that a mere "notice plus check writing" is not sufficient to authorize a debit from the consumer's account for any amount other than the face amount of the check.

Appendix A-6(c): Optional notice

We support the requirement that this model notice at least tell the consumer under what circumstances check processing, rather than electronic check conversion, will be used. We do not believe that this notice will be particularly effective at actually communicating the choices to be made by the merchant or processor to the consumer. However, a consumer should at least be told of the circumstances in which conversion will not occur. We do not favor a more restrictive notice only because such notice might deter use of electronic check conversion in favor of check imaging. For the reasons already discussed, that would be a bad result for consumers.

Comment 205.10(b)-7: Bona fide error

The addition to this comment is a sensible one except in one respect. The comment suggests that where a financial institution has accepted a telephone or online preauthorized charge to a card which is a debit card while believing, in spite of reasonable procedures, that the order is for a charge to a credit card, the financial institution may comply with the obligation to obtain written consent either by obtaining the written authorization or by ceasing to debit the account. We agree that an unauthorized debit must cease, unless and until authorized in writing. We suggest that this comment should require prompt notice to the consumer that the previously orally authorized charge has been stopped. A consumer may assume that a preauthorized arrangement is paying a periodic bill. Ceasing the periodic charge without prompt notice to the consumer could have adverse fiscal consequences for the consumer, who may not realize that the bill is no longer being automatically paid. For this reason the option of ceasing to charge the card should include a requirement for prompt notice to the consumer (upon or after cessation of the debit) that the charge will no longer be made.

Comment 205.10(c)-2 and 205.10(c)-3: Right to stop payment

The reference in comment 10(c)-2 to new comment 10(c)-3 might suggest that even when a consumer has revoked an authorization for previously authorized debits, the financial institution may comply with stop payment requirements through a third party (if the payment is, in fact, stopped). We support the position of new comment 10(c)-3 that makes it clear that the financial institution is responsible if the third party fails to stop a preauthorized debit as requested. With respect to a revocation of authorization, rather than simply an order to stop or skip a particular payment, however, it seems that the financial institution's obligation should involve not only invoking the third party's stop procedures, but also permanently canceling the third party's ability to charge the account for that debit. The reference in comment 10(c)-2 to comment 10(c)-3 seems to suggest that involving the third party's stop payment procedures is sufficient, rather than permanently revoking the authorization for the third party to debit the account.

Comment 205.10(d)(2)-2: Transfers varying in amount

This new comment authorizes periodic transfers varying in amount from an account without prior consumer consent. This may not be problematic for the types of accounts described in the explanatory materials, such as certificates of deposits. However, it could be troubling when the transfers are from a transaction account. Transfers out of a transaction account without notice to or authorization by the consumer for the specific amount of the debit could result in difficulties in tracking balances, and thus in dishonored items drawn on that account.

In addition, there is a growing industry dedicated to facilitating transfers out of a consumer's account, for example, to repay remotely-arranged payday loans. We are deeply concerned that any authorization for transfers that need not be preauthorized with specificity could have the effect of facilitating payday lending collection, or facilitating repeated re-presentments well beyond the NACHA numeric limit, perhaps by arguing that the consumer has preauthorized a transfer varying in amount through some prior general authorization. We respectfully suggest that either the proposed change not be adopted, or that the new process be strictly limited to the prearranged transfer solely of interest earned in one account to another account held in the same name.

The Board also invites comment on whether there are circumstances where the "four walls" rule should not apply. We strongly believe that there are. The financial institution is in the best position to investigate an alleged error. Even if that investigation requires the cooperation of others, the financial institution is in a better position than the consumer to induce that cooperation.

A processing error affecting a large number of consumers earlier this year illustrates the need for an obligation on the financial institution to make inquiries beyond its own records. On April 1, 2004, approximately 800,000 consumers who had made a purchase at a WalMart store the preceding day found that they had been double, and in some cases, triple, charged on the debit or credit card which they had presented for payment. *Wal-Mart Bill Error No April Fools' Joke*, Denver Rocky Mountain News; April 06, 2004; Chris Walsh, Rocky Mountain News. www.static.highbeam.com/d/denverrockymountainnews/april062004/walmartbillerrornoaprilfoolsjoke/. That problem stemmed from a processor error, not from the merchant, and those consumers received prompt credits. However, if the same problem had occurred for only a few consumers, rather than hundreds of thousands of consumers, those individual consumers might easily have been told by their financial institutions that the financial institution's records showed two valid

payment orders, and therefore no error showed in the records and no recredit would be given under the EFTA. Clearly, the financial institution has more ability than the average consumer to make inquiries to the processor. The financial institution's records will identify the processor, while the consumer knows only that he or she presented the card at a particular merchant. The processor may need to examine the financial institution's record of the payment order as part of determining if there was an error. The consumer doesn't have access to those records. Finally, financial institution staff can be trained to ask the right questions to make a simple and effective inquiry to the processor or to a merchant's payment processing staff. By contrast, the consumer doesn't speak the language of ACH or debit card payment processing, and may have trouble identifying, and getting through to, the right person at the processor or the merchant's payments processing department.

Consumer discouragement when faced with the need to sort out ACH processing problems is real. Here is what one consumer (name withheld) told U.S. PIRG in an email on October 28, 2004: "Last month I wrote a check to J.C.Penney and mailed it snail mail (while talking on the phone with an acc rep & her knowing I was mailing her a check). About a week later while doing my online banking, I noticed the check had cleared but it cleared for 70.00 and the check I wrote was for 20.00. Beside the check it said it was a check debit transaction. My bank had no copy & JC Penney told me that my bank did have a copy.....and then Pennys said they had no copy...so what now...I gave up...If this is a sign of more to come then I believe the finances of all consumers are in jeopardy. I'm small time compared to big corporations. I just want a copy of my check to prove my payment."

Eliminating the four walls rule will help to avoid this situation for consumers.

Comment 205.11(c)(4)-5: Scope of investigation in the absence of an EFT agreement

We are in strong support of the new comment 5, which honors the requirement of Regulation E that a financial institution must in all cases review its own records in investigating an allegation of error. We agree strongly with the reasons given in the explanatory material for this change. The number and variety of ACH payments has expanded significantly since the "four walls" rule was first developed, and consumers may find that they are simply unable to effectively dispute an erroneous or unauthorized payment unless the financial institution must look beyond the payment order.

The comment appropriately states that the obligation to review records includes the obligation to review all information within the financial institution's own records which is relevant to resolving the claim. We read "own records" in this context to be all the records held by or for, or within the control of, the financial institution. It would be helpful for the explanatory material to so state, to avoid future disputes. For example, there could be a dispute about whether this obligation requires a financial institution to review records held by entities that provide outsourced services to the financial institution relating to EFTs where outsourcer does not have an agreement with the financial institution for the particular type of EFT that is the subject of the dispute. In addition, it would be useful to delete the reference to records that may be dispositive, since the obligation to examine the institution's own records should extend to all relevant records of the financial institution, including those that will be helpful, but not dispositive, of the claim.

Comment 205.16(b): Disclosures at ATMs

This comment could significantly weaken consumer notice. Financial institutions should be permitted to specify on an ATM screen those types of EFT services for which they impose fees, and the amount of each fee (and, if they like, the types of services or cardholders where there will be no fee). However, this comment allows a much weaker form of disclosure – that the financial institution may impose a fee for EFT services. This disclosure is too general to be useful. It does not use terms consumers are likely to understand, such as "cash withdrawal" "deposit" or "balance inquiry." It does not require that the amount of the fee be given for any service, nor even that the disclosure even indicates which services trigger a fee and which do not. Consumers can't be wise, informed shoppers without information about which services will trigger a fee before using those services. Thus, the very general disclosure permitted by this comment undermines the purpose of fee disclosure. We urge that the portion of the changes to this comment permitting a general notice that there may be a fee for EFT services be deleted. This would leave the change in the comment that permits the financial institution to notify a consumer that a fee may be charged for specific, identified types of EFT services.

Thank you for the opportunity to comment on these proposed regulations.

Very truly yours,

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