



November 16, 2004

VIA E-MAIL

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

**Re: Docket No. R-1210; Regulation E -- Electronic Fund Transfers**

Dear Ms. Johnson,

SWACHA - The Electronic Payments Resource<sup>1</sup> is pleased to submit our response to the Federal Reserve Board ("Board") on its request for comment on proposed changes to Regulation E and its Official Staff Interpretation ("Commentary"). Overall, the proposed changes will provide greater clarity and flexibility to payees and their financial institutions in terms of consumer disclosure and the types of electronic check conversion applications that offer consumer protection coverage under Regulation E. In addition, we support the inclusion of certain payroll cards in coverage of Regulation E. We believe the Board's approach will advance the marketplace's ability to deploy and administer multiple consumer payment options, to the benefit of consumers, merchants, billers and financial institutions.

However, there are some issues on which, on behalf of the industry, we seek further clarification or on which we question whether the proposed change is merited for our membership in general and the ACH network in particular. Our comments below address each of the Board's proposed changes to the regulation or Commentary to the extent each change would directly impact our constituents or the ACH network.

**Electronic Check Conversion/ACH Transactions**

*Background:* In an electronic check conversion transaction (referred to by the Board in the proposal as an "ECK transaction"), a consumer provides a check to a payee and information from the check is used to initiate a "one-time" EFT from the consumer's account. Specifically, the payee electronically scans and captures the MICR-encoding on the check for the routing, account, and check serial number, and enters the amount to be debited from the consumer's asset account. The *Electronic Fund Transfer Act* ("EFTA") expressly provides

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<sup>1</sup> SWACHA - The Electronic Payments Resource™ is one of the largest regional payments associations in the nation, representing over 1,000 banks, credit unions and savings institutions that participate in the payments system. SWACHA is an official source for the ACH Operating Rules and represents its members in national issues and the rule-making process. SWACHA's mission is to be the resource of choice for education, training, representation and knowledge regarding electronic payments and payments system risk.

that transactions originated by check, draft, or similar paper instrument are not governed by the Act. In response to requests by industry stakeholders that the Board clarify EFTA coverage of ECK transactions, the Board's March 2001 amendments to the Commentary to Regulation E established a bright-line test for the regulation's coverage of these transactions [6 FR 15187 (March 16, 2001)].

The Commentary now provides that the EFTA and Regulation E cover ECK transactions if the consumer authorizes the transaction as an EFT. A consumer authorizes an EFT if notice that the transaction will be processed as an EFT is provided and the consumer completes the transaction. This is the case regardless of whether check conversion occurs at the point-of-sale or in an accounts receivable conversion transaction where the consumer mails a fully completed and signed check to the payee.

Since revising the Commentary in March 2001, several issues have arisen relating to ECK transactions. The Board indicates it has concerns about the uniformity and adequacy of some of the notices provided to consumers about ECK transactions. We share the Board's concern about the adequacy of notices. Also, some in the industry would like the flexibility to obtain a consumer's authorization to process a transaction as either an EFT or as a check. Board staff has also received inquiries from financial institutions and other industry participants concerning their obligations under Regulation E in connection with ECK services. For example, merchants and other payees have inquired whether a single authorization is sufficient to convert multiple checks submitted as payment after receiving an invoice or during an individual billing cycle. Banks and credit unions have asked about the extent of their disclosure obligations to both existing and new consumers about the addition of ECK services to the terms of consumer accounts. SWACHA has also heard similar concerns from our members and from the industry.

*Proposed Revisions:*

**Regulation E Coverage of ECK Transactions:** The regulation would be revised to incorporate the guidance on Regulation E coverage of ECK transactions currently contained in the Commentary [Sec. 205.3(b)(2)(i)]. Where a check, draft, or similar paper instrument is used as a source of information to initiate a one-time EFT from the consumer's account, that transaction is not deemed to be a transfer originated by check and thus is covered by Regulation E.

New paragraph 3(b)(2) would be added to the related Commentary. This Commentary would clarify that an ECK transaction covered by the regulation is one in which “a consumer authorizes a one-time EFT (in providing a check to a merchant or other payee for the MICR encoding, that is, *the routing number of the financial institution, the consumer's account number and the serial number*), where the consumer receives notice that the transaction will be processed as an EFT and goes forward with the transaction ... [emphasis added].”

**Comment:** SWACHA supported the March 2001 clarification in the Commentary whereby a check could be used as a source document to initiate an ACH transaction with

proper consumer authorization. This clarification represents a significant underpinning of the legal foundation upon which ECK payment products are offered. The *NACHA Operating Rules* (“NACHA Rules”) reflect this legal clarification and enhance it through the rules applicable to ECK transactions that are processed through the ACH network. Moving the clarification from the Commentary to the Regulation strengthens this legal foundation on which so many consumer payment options are now being offered or envisioned.

We also support the additional clarification proposed in Commentary paragraph 3(b)(2) noted above. Our interpretation of this Commentary is that coverage of transactions under the regulation as “ECK transactions” would be limited to cases in which a physical check is provided to or received by a payee for the purpose of capturing the full MICR line (i.e., routing number, account number and check serial number) to originate an EFT. In the ACH network, this would embrace POP and ARC entries, for example, since these entries contain the full MICR line as captured from a physical check. On the other hand, other “one-time” ACH transactions, in which a consumer may rely on the MICR-encoded information on the check to provide the correct routing and account number information to the payee, would not trigger coverage under the regulation as “ECK transactions” subject to the proposed notice requirements, etc. They would, of course, continue to be covered by other provisions of Regulation E as applicable.

**Notices; Consumer’s Financial Institution:** The Commentary would also clarify that electronic check conversion transactions are a new type of transfer requiring new disclosures to the consumer (to the extent applicable) by the consumer’s financial institution [Comments 7(b)-4 and 7(c)-1]. Model clauses for initial disclosures would be revised to reflect that one-time electronic funds transfers may be made from a consumer's account using information from the consumer's check and to instruct consumers to notify their account-holding institutions when an unauthorized EFT has occurred using information from their check [Appendix A, Model Clauses in A-2].

**Comment:** We believe the proposed Commentary 7(b)(4) and related model clauses in Appendix A-2 for initial disclosures would be helpful to consumers, provided that sufficient time is provided for financial institutions to make disclosures. Since this change, as well as other proposed changes to the notice requirements, would require financial institutions to modify and reissue their Regulation E disclosure statements, we believe at least one year should be provided from the date of adoption to comply with the revised notice requirement.

**Consumer Authorization & Notices; Payees:** The Board would use its authority under the EFTA to require parties, such as merchants and other payees, that make ECK services available to consumers to obtain a consumer's authorization for the EFT [Sec. 205.3(a) and (b)(2)(ii)-(iii); and Comment 3(b)(2)-1]. Generally, a “clear and conspicuous” notice for authorization would have to be provided for each ECK transaction. The notice could be a generic statement posted on a sign or a written statement at the point of interaction with the consumer, or provided on or with a billing statement or invoice with respect to an accounts receivable transaction. To help consumers understand the nature of an ECK transaction, the regulation would require the party initiating the EFT to notify the

consumer that when the transaction is processed as an EFT (1) funds may be debited from the consumer's account “quickly,” and (2) as applicable, the consumer's check will not be returned by the consumer's financial institution. Further, the Board proposes several model clauses for notices to provide payees with a safe harbor from liability under Sections 915 and 916 of the EFTA if the payee uses one of the clauses that accurately reflects its services [Appendix A, Model Clauses in A-6].

The Board believes the proposed requirements and model clauses would enable it to promote consistency in notices provided to consumers by merchants and other payees.

Additionally, the Board seeks comment on whether payees should be required under Regulation E to obtain the consumer’s “written signed authorization” to convert checks at the point-of-sale.

***Comment:*** We concur with the Board that basic minimum authorization requirements and the related notice and safe harbor provisions for payees will lead to consumers being better informed on a consistent basis about their ECK transactions. We further believe that the authorization and notice requirement would not pose a significant or immediate compliance burden on payees currently engaged in ECK transactions through the ACH network since the *NACHA Rules* already address authorization and notice requirements for such parties.

*Payee notices.* We believe that limiting the model disclosure language for ECK transactions to one sample notice would be sufficient and still be of great value to payees and consumers. This approach is also consistent with safe harbor notice language in other consumer protection regulations.

With respect to adopting a single sample notice, we generally support consolidating the relevant language across the three types of proposed model notices to address the various options that would be available to payees for ECK transactions, and eliminating the specific language related to proposed Sec. 205.3(b) (2)(iii) regarding (1) the timeframe in which an EFT may clear (“quickly”), and (2) the statement that the consumer will not receive their check back from their financial institution.

Generally, we believe the proposed regulatory and notice language we seek to eliminate from the final rule would be more confusing than helpful to the consumer for the following reasons:

1. Clearing timeframe. We object to the proposed regulation and model disclosure language that would represent to consumers that, when their transaction is processed as an EFT, funds may be debited from the consumer's account “[quickly/as soon as the same day we receive your payment].” We believe there is no absolute validity to these claims when they are viewed relative to existing check collection timeframes. In some instances, the EFT may indeed clear more quickly than the check, particularly if the check is non-local and has to be physically transported to the paying bank for collection. However, in majority of cases, the EFT will clear in roughly the same period of time, if not longer.

Most checks used for payment in the U.S., especially when the consumer is present at the point of interaction, are considered local items and, generally, will clear locally. Local clearing timeframes can run from same-day to next-day, depending on such factors as the means used by the bank of first deposit to collect the item (e.g., deposit with its Federal Reserve Bank, exchange through a local clearing house, etc.) and the time of day the item is deposited by the payee. Rarely would a local check take longer than the next day to clear. Further, with the recent implementation and continuing evolution of paper checks being cleared under the framework of Check21, even non-local checks may clear much more quickly to the point of having the same timeframe as local checks. We are concerned that this proposed language for Regulation E vis-à-vis the evolving Check21 environment may confuse rather than inform consumers.

Collecting the payment as an ACH transaction involves the payee batching its ACH transactions, sending to a third-party or directly to its financial institution for further processing, and collection via the interbank ACH network. Typically, this will result in the transaction clearing as an ACH entry in one to two days from the point of conversion. Consequently, we believe it would be inappropriate for the Board to make any reference to check vs. EFT clearing timeframes in its model disclosures.

2. Return of check to consumer. SWACHA recognizes the Board's intent in requiring payee notices to indicate that, if used to initiate an ECK transaction, the check itself will not be returned to the consumer, as applicable. However, in practice, we believe such required disclosure would confuse consumers that already do not receive checks back from their financial institutions with their monthly statements and, possibly, in relation to consumer experiences in the new Check21 environment.

With respect to this latter point, consumers may tend to equate a statement that they will not receive their check back from a payee authorizing an ECK under Regulation E with similar statements from their financial institution with respect to check handling under Regulation CC as amended to implement Check21. In such cases, if a consumer has a dispute about a payment processed as an ECK transaction, the consumer may inadvertently seek to dispute the transaction as a check transaction under Regulation CC. Such confusion on the part of the consumer will undoubtedly cause an additional burden on our members to ascertain the correct procedures (Regulation E error resolution vs. Regulation CC error resolution) to follow.

*Requiring a written signature at point-of-sale?* While SWACHA supports a minimum authorization and notice standard for ECK transactions, we would point out that individual EFT network rules may establish additional authorization requirements. While consistent with the Board's existing and proposed minimum authorization standard, these network rules may, in fact, provide superior consumer protection and are typically structured such that they reflect the unique qualities of the specific type of EFT application being used for the ECK transaction. For example, the NACHA Rules currently apply specific and distinct authorization and notification requirements in the origination of POP, RCK, ARC and other ACH network applications.

In all cases, these authorization requirements reflect the unique operating environment, risk mitigation strategies, and transactional characteristics associated with each application. In fact, one of the primary reasons why the NACHA Rules establish unique SEC codes to distinguish between multiple types of ECK transactions using the ACH is the different authorization, notification, and authentication requirements deemed necessary for each type of transaction by the industry. We believe a payments system rules-driven approach is preferable to an approach that attempts to throw a regulatory blanket over all possible scenarios.

Accordingly, SWACHA believes the Board should not require “written signed authorization” at the point-of-sale through Regulation E. Instead, we believe the Board should make very clear through the regulation or its Commentary that the Board’s authorization requirements and standards are minimum requirements upon which any consumer EFT application must rely, but payment network and other applicable rules and laws may result in additional authorization requirements as applicable.

As the deployment of existing consumer EFT products increases and as new applications are developed, such clarity by the Board of the regulation’s application vis-à-vis other relevant rules and laws is absolutely necessary to avoid marketplace confusion and, potentially, legal challenges that do not look beyond Regulation E for determining the rights and obligations of the parties involved.

**Receipt Of Multiple Checks:** The regulation would provide that obtaining authorization from a consumer holding the account on which a check will be converted is sufficient to convert multiple checks submitted as payment for a particular invoice or during an individual billing cycle [Sec. 205.3(b) (2)(ii)].

**Comment:** Now that the industry has had several years experience with various ECK applications using the ACH network, we have sought clarification through Regulation E and/or its Commentary of practical matters related to consumer and payee payment relationships and practices. In general, the proposed changes regarding EFT authorization and disclosure should be quite beneficial to consumers, merchants and billers in clarifying these matters. Specifically, clarifying in the regulation that only one EFT authorization would be necessary for a payee to convert multiple checks received in a single billing period represents a very practical recognition of a common payment practice.

**Consumer Disclosure Addressing Multiple Collection Scenarios:** A proposed revision to the Commentary would explain that a payee may obtain the consumer’s authorization to process a transaction as an EFT or as a check [Comment 3(b)(2)-2]. This Commentary recognizes cases where (1) an EFT could not post due to processing or technical errors, whereby the payee could use the original check or create a substitute check to collect the returned EFT, and (2) the payee would have the discretion to initiate collection of the payment as either an EFT or as a check (including substitute checks allowed under Check21/Regulation CC), depending on which process is the most efficient.

**Comment:** This clarification is necessary and will advance the use and acceptance of EFT as an alternative to check collection for consumer payments. Again, with several years' experience with ECK applications using the ACH Network, and particularly with the implementation of Check21 in mind, SWACHA believes that the merchant and biller communities require greater flexibility in terms of how consumer checks may be used in the payment process. By clarifying that, with appropriate authorization, a check may be collected as a check, or used as a source document to initiate an EFT; payees will have much greater latitude in determining, at the transaction level, the most cost-efficient, lowest risk, and practical means for collection.

### **Error Resolution**

Sec. 205.11(c)(4) currently provides that a financial institution may satisfy its obligation to investigate an alleged error by reviewing its own records if the alleged error concerns a transfer to or from a third party and there is no agreement between the institution and the third party for the type of EFT involved. The Commentary would be revised to state that, under these circumstances, the financial institution would not satisfy its error resolution obligations by merely reviewing the payment instructions if there is additional information within the institution's own records that would assist in resolving the alleged error [Comment 11(c)(4)-5].

**Comment:** SWACHA believes the proposed clarification may further confuse the duties imposed upon our financial institution members. We often receive inquiries from our members regarding interpretation of the "four walls" rule and have found this portion of the Commentary troublesome for our members. Further, we believe the proposed language could impose additional requirements on financial institutions that they are not necessarily in a position to perform. The institution is unlikely to have readily available and concrete information in its records that would assist in the review of the particular transaction, e.g. the consumer's authorization is with the originator of the transaction; yet searching for and obtaining such additional information would be a time consuming and costly process.

Under the NACHA Rules, a financial institution that is requested to investigate an ACH transaction, which their consumer customer states is unauthorized, will review the transaction details. If the consumer executes a written statement under penalty of perjury, the financial institution will promptly re-credit the consumer and return the transaction if within the prescribed timeframe.

Further, engaging in a more extensive investigation than is currently required in the regulation would potentially place the consumer and the consumer's financial institution in an adversarial position to the degree that such investigation might call into question issues raised by the transactions. For example, a consumer may have legitimately authorized a payment and now the consumer is disputing the validity of the authorization. Since the authorization is between the consumer and the originator of the transaction, our member may be placed in the position of deciding the legitimacy of the authorization. This is an issue that should be resolved between the originator and the consumer, not the financial institution and its customer. We would view the proposed Commentary as somewhat confusing, potentially

onerous to financial institutions and overreaching regulation given the fact that the consumer is made whole in a timely manner under the NACHA Rules.

### **Preauthorized Transfers**

**Tape recording of telephone conversations:** Sec. 205.10(b) requires that recurring electronic debits from a consumer's account be authorized "only by a writing signed or similarly authenticated by the consumer." The March 2001 Commentary update clarified that the writing and signature requirements of this section could be satisfied by complying with the *Electronic Signatures in Global and National Commerce Act* ("E-Sign Act") [See current comment 10(b)-5]. The Commentary currently provides that a tape recording of a telephone conversation with a consumer who agrees to preauthorized debits does not constitute written authorization under Sec. 205.10(b) [Comment 10(b)-3]. However, the Board proposes to withdraw this interpretation in the Commentary "to address industry concerns that the existing guidance may conflict with the E-Sign Act."

**Comment:** SWACHA is concerned that, by withdrawing the reference to a tape recorded telephone conversation not constituting written authorization without additional guidance with respect to the E-Sign Act, the Board will only further confuse the issue and call into question business models currently employed in the marketplace.

Therefore, instead of merely withdrawing this clarification from the Commentary, we believe it is incumbent upon the Board to clearly address, through the Commentary, whether a recorded telephone conversation is or is not consistent with the E-Sign Act and, therefore, considered an acceptable form of written authorization for the purposes of Regulation E compliance.

**Stop Payment Orders:** Sec. 205.10(c) requires a financial institution to honor a consumer's oral stop-payment order for a preauthorized transfer from his or her account if it is made at least three business days before a scheduled debit. The Commentary would be revised to clarify that an institution that does not have the capability of blocking a preauthorized debit from being posted to the consumer's account (for example, when debits are made on a real-time system), may instead use a third party to block the transfer(s), as long as the recurring debits are in fact stopped [Comments 10(c)-2 and -3].

**Comment:** In reviewing this proposed change, SWACHA has received inquiries as to whether it would also apply to the ACH Network (despite of the Board's reference to real-time systems as an example in the proposal). To ensure there is no confusion if this change is adopted, SWACHA encourages the Board to include in the Commentary to Sec. 205.10(c)(3) that the provision specifically does not apply to preauthorized debits in batch EFT systems like the ACH network.

More importantly, SWACHA seeks clarification of a long-standing issue related to the Commentary's treatment of stop payment orders and its reference to revocation of authorization [current Comments 10(c)-1 and -2, respectively] as follows:

1. Stop payment orders. SWACHA seeks revisions to Comment 10(c)-1 to recognize that a stop payment order stops a single EFT transaction and is requested by the consumer of the consumer's financial institution. Further, under the current Commentary, it may be inferred that financial institutions are required or expected to maintain a stop payment order in perpetuity. We strongly believe that Comment 10(c)-1 should also be revised to clearly recognize that stop payment orders on EFTs need not be maintained by the consumer's financial institution for longer than 6 months, which would bring Regulation E into harmony with accepted industry practice and create a regulatory approach which reflects traditional check collection practices and laws. As the bright line distinction between payment systems continues to blur, operational consistency is key to the continued development of efficient and cost effective processing. This time period is specifically prescribed for stop payment orders on checks per Article 4-403 of the Uniform Commercial Code, and is the basis on which industry stop payment systems are built.

2. Revocation of authorization. As noted above, a stop payment order is intended to stop a single payment transaction, not a stream of subsequent transactions. We believe the EFTA and the regulation support this and find no foundation in either for Comment 10(c)-2. Therefore, we believe the comment should either be removed or modified so that it clearly recognizes industry practices – i.e., that revocation is between the consumer and the payee, and that the consumer's financial institution is not typically in a position to verify that an authorization has been revoked or to automatically return subsequent EFT transactions if received.

### **Payroll Cards**

SWACHA supports the Board's proposal to extend Regulation E to payroll cards. In general, we believe that Regulation E should apply only to those payroll cards that mimic traditional deposit accounts.

Under the proposal, a payroll card account established by an employer on behalf of a consumer to which EFTs of the consumer's wages, salary or other employee compensation are made on a recurring basis would be an "account" covered by Regulation E. Regulation E would apply regardless of whether the funds are held in individual employee accounts or in a pooled account, with "subaccounts" maintained by a depository institution (or by a third party) that enable a determination of the amounts of money owed to particular employees. Regulation E would not apply to 1) other types of stored value cards (e.g. gift cards) or 2) a card used for a one-time EFT of a salary-related payment, such as a bonus, or a card used solely to disburse non-salary-related payments, such as petty cash or a travel per diem card.

We believe that it is good public policy to provide Regulation E coverage to those payroll cards that mimic traditional deposit accounts. These types of arrangements clearly attribute funds to a particular cardholder. We believe that payroll cards should be subject to Regulation E only when a clearly identifiable account can be tied to a particular consumer.

Other forms of payroll cards are designed only to provide an alternative to a paycheck. They are not designed to function like a traditional deposit account that accepts

multiple credits and debits and identifies a specific individual with a specific account number and account balance. Accordingly, Regulation E should not apply to these arrangements.

While we support the public policy behind the proposed amendment, we are concerned about the practical implications of extending Regulation E to payroll cards. For example, some payroll card recipients are transitory, such as college students or migrant workers. These individuals may only live in a given location several months each year. If payroll cards were subject to Regulation E, financial institutions would be required to distribute periodic statements to each payroll card recipient. It is likely that many account statements would be returned to the issuing institution because the worker has moved on to another geographic location. The operational burden on financial institutions to make proper and, more importantly, meaningful disclosures through period statements to a migratory community may pose a significant barrier to entry for our members.

Further, regulatory uncertainties persist regarding the application of Regulation E, Regulation CC, and the USA Patriot Act to these products. Moreover, our member financial institutions must partner with third party vendors to make stored value products economically feasible. While many community based financial institutions are monitoring the stored value market, many have been reluctant to enter the stored value market due to these continuing uncertainties.

Even though our members are exploring the payroll card market, we are concerned that imposing different level of regulation on depository institutions and less regulated providers of stored value products may discourage innovation and could potentially eliminate insured institutions as major participants in the development of payroll card products. We urge the Board to ensure that all providers of payroll card services are treated equally under any amendment to Regulation E.

SWACHA appreciates the opportunity to comment on this proposal. If you have any questions regarding our comments, I may be reached at (214) 953-4720 or via e-mail at [dennis.simmons@swacha.org](mailto:dennis.simmons@swacha.org).

Sincerely,

/s/ Dennis E. Simmons

Dennis Simmons, AAP  
President & CEO

Cc: SWACHA Board of Directors