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VIA E-MAIL

November 19, 2004

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

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

Dear Ms. Johnson:

On behalf of EastPay, an electronic payments association representing over 650 financial institutions in VA, WV, NC and FL, I respectfully submit this response to the Federal Reserve Board ("FRB") on proposed changes to Regulation E and its Official Staff Interpretation ("Commentary").

A. 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 that transactions originated by check, draft, or similar paper instrument are not governed by the Act. In response to requests by NACHA and other 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)].

*Proposed Revisions:*

**A1. 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 (i.e., as a "source document"), 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]."

**EastPay Comment:** By adding this to the Regulation, it will strengthen its' legal foundation. The NACHA Operating Rules currently reflect this clarification and we believe that this is a much-needed change.

**A2. 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 EFTs 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].

**EastPay Comment:** This change would be helpful to consumers; we hope that a sufficient timeframe will be given to financial institutions so they are given enough time to implement this change. We believe that one year from the date of adoption would be sufficient to comply with the revised notice requirement.

**A3. 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 POS, or provided on or with a billing statement or invoice with respect to an ARC 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 protect payees from liability under Sections 915 and 916 of the EFTA (i.e., a "safe harbor"), if the payee uses the clauses accurately to reflect 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 (e.g., for POP entries in the ACH Network).

**EastPay Comment:** We do believe that basic minimum authorization requirements and the related notice and safe harbor provisions for payees may lead to better informed consumers about their ECK transactions. As for the authorization/notice requirement, we do not believe it would pose a significant compliance burden on payees since the *NACHA Rules* already address authorization requirements for Originators.

**Payee notices.** The addition of a "sample" notice [Appendix 6(a)] and two "optional" notices [Appendix A-6(b) and (c)] is too cumbersome. We believe that limiting the model disclosure language for ECK transactions to one sample notice would be sufficient notice to consumers.

Specifically, EastPay would object to the language that would inform customers of potential changes in the clearing times of their payments. With the rapid changes occurring in payments, specifically with Check 21, non-EFT payments may in fact clear even faster than EFT items, depending upon local vs. non-local arrangements. Similarly, the reference to the customer's check not being returned would seem to provide more confusion than clarification especially for a

significant and growing base of customers who do not currently get their checks returned anyway. A statement could be provided to reassure customers that their financial institution's account statement will contain sufficient information to both identify and provide proof of payment.

*Requiring a written signature at point-of-sale.* EastPay supports a minimum authorization standard for ECK transactions. We believe that the NACHA rules provide superior consumer protection and are purposely categorized in an effort to reflect the unique qualities of the specific type of EFT application being used for the ECK transaction. The NACHA Rules currently apply detailed authorization requirements for the origination of POP, RCK, ARC and other ACH Network applications. These authorization requirements are designed to assist financial institutions manage the unique risk associated with each application.

EastPay believes the Board should not require "written signed authorization" at the point-of-sale through Regulation E. As a substitute, we believe the Board clearly state, through the regulation or its Commentary that the Board's authorization requirements and standards are minimum requirements. We strongly believe that it should be noted that in the Regulation that payment network and other applicable rules and laws may result in additional authorization requirements.

**A4. 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)].

*EastPay Comment:* Clarifying the regulation so that only one EFT authorization would be necessary for a payee to convert multiple checks received in a single billing period simply recognizes a common payment practice. This provides businesses with sufficient latitude in developing an efficient collection process without infringing on the rights of the consumer, as they have the flexibility to opt out under the ACH rules.

**A5. 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 (i.e., an administrative return), 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.

*EastPay Comment:* This is a much needed clarification and will help move forward the use and acceptance of EFT as an alternative to check collection for consumer payments. The ACH Network has been using ECK transactions for several years now and with the implementation of Check 21 EastPay believes that merchants and billers are seeking greater flexibility in how consumer checks may be used in the payment process. With this clarification, a check may be processed as a check, or used as a source document to initiate an EFT.

**A6. Authorization for Collecting Fees for Insufficient Funds:** The Board proposes to clarify that payees may electronically debit a consumer's account for a fee for insufficient funds when the consumer goes forward with a transaction, it is returned for insufficient funds, and the consumer has received notice that such a fee could be collected electronically [Comment 3(c)(1)-1].

**EastPay Comment:** The *NACHA Rules* currently require that an ACH debit to a consumer's account to collect a fee for insufficient funds must be authorized by the consumer in writing. The Board's proposal is not inconsistent with this ACH Network requirement. We believe that the interest of the consumer should be considered and that the Board should clarify in the regulation that payments system rules may provide additional requirements when those systems are used to process an EFT otherwise covered by Regulation E.

## **B. 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].

**EastPay Comment:** EastPay believes that this change could impose additional requirements on RDFI's that they would not likely be in a position to accomplish. Any RDFI that is requested to investigate an unauthorized ACH transaction will review the transaction details and, if the consumer executes a written statement under penalty of perjury, will promptly re-credit the consumer and return the transaction, if within the prescribed timeframe. The RDFI will most not likely have any additional information in its records that would assist in the review of the particular transaction. A detailed search for such additional information could be a time consuming and costly process to the RDFI. We believe the proposed Commentary is confusing and unnecessary given the fact that the consumer is fully covered under the *NACHA Rules*.

## **C. Preauthorized Transfers**

**C1. 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."

**EastPay Comment:** EastPay is concerned that removing the tape recorded telephone conversation reference will cause confusion. Instead of merely withdrawing this clarification from the Commentary, we believe the Board should clearly address, through the Commentary, whether a recorded telephone conversation is or is not consistent with the E-Sign Act.

Thank you for the opportunity to comment. If you have any questions, please call me at 804-644-1642.

Sincerely,

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Bradley W. Smith, AAP  
Director of Network Services  
EastPay, Inc.

cc: EastPay Board of Directors