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November 19, 2004

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

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on a proposal by Board of Governors of the Federal Reserve System (Board) to amend Regulation E, which implements the Electronic Fund Transfer Act (EFTA), and the commentary.

The proposed revisions would extend Regulation E to merchants or other payees converting paper checks to electronic fund transfers, require notice to the consumer for each transaction, and require merchants to obtain the consumer's authorization. Additionally, under the proposed revisions, certain payroll cards would be subject to Regulation E. Proposed commentary revisions would provide guidance on preauthorized electronic transfers from a consumer's account, additional electronic check conversion issues, error resolution, and other matters.

ICBA Comments

ICBA appreciates the Board's willingness to revise Regulation E to address issues resulting from our dynamic payments marketplace. Our comments are summarized below.

¹ *The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to promoting the interests of the community banking industry. With nearly 5,000 members, ICBA members employ more than 225,000 Americans and hold more than \$778 billion in total assets. For more information, visit ICBA's website at www.icba.org.*

- ICBA supports incorporating commentary guidance in Regulation E regarding the applicability of the EFTA and Regulation E to electronic check conversion transactions.
- ICBA supports proposed uniform notice requirements, with certain modifications, for merchants and other payees initiating electronic check conversion transactions.
- ICBA opposes modifying Regulation E to require merchants and other payees to obtain the consumer's written signed authorization to convert checks received at the point of sale. This issue is more appropriately addressed in Network Operating Rules, such as the *NACHA Operating Rules*, as is the case today.
- ICBA strongly opposes a disclosure that would identify potential risks or harm to consumers resulting from electronic check conversion and circumstances under which a check may or may not be used to initiate an EFT.
- ICBA supports clarifying that a consumer gives authorization when the consumer proceeds with the transaction after receiving notice that any insufficient funds fee would be collected electronically.
- ICBA supports extending Regulation E coverage to payroll card programs, with an exemption from the periodic statement requirement, and supports a one-year implementation time frame.
- ICBA supports exempting prepaid gift cards from Regulation E.
- ICBA disagrees with the Board's assertion that payroll card accounts are substitutes for traditional checking accounts.
- ICBA requests clarification as to whether Regulation E would apply to programs where a distributor on a recurring basis pays commissions to consumers using stored value cards offering some of the same functionality as payroll card programs.
- ICBA believes it is inappropriate for the Board to rely on the Federal Deposit Insurance Act rather than the EFTA to trigger the applicability of Regulation E.
- ICBA supports financial institutions having the flexibility to issue more than one access device in conjunction with the renewal or substitution of a previously accepted access device.
- ICBA requests the Board revisit issuing additional guidance regarding the circumstances necessary for a financial institution to satisfy its error resolution obligations.
- ICBA supports clarifying a financial institution's obligations if a consumer fails to provide notice of an alleged error within the specified time limits.
- ICBA supports withdrawal of a commentary provision regarding tape recordings of consumer telephone conversations constituting written authorization.
- ICBA supports other commentary clarifications related to preauthorized transfers.

- ICBA supports modifying ATM signage to disclose that a fee **may** be imposed, in instances where all ATM users are not charged a fee for ATM usage or certain transactions.

Electronic Check Conversion

Merchants and other payees are increasingly using a paper check provided by a consumer as a source document to initiate a one-time EFT from the consumer's account in lieu of presenting the paper check for processing and settlement. The paper check may be blank, partially completed, or fully completed and signed; presented or mailed to a merchant, payee, or lockbox; and retained by the consumer, merchant payee, or the payee's financial institution. This process, generally known as electronic check conversion or ECK, permits the payee to scan and capture a check's MICR-line information to create an EFT.

Currently, the Board's staff commentary provides that EFTA and Regulation E cover ECK transactions if the consumer authorizes the EFT transaction. A consumer gives authorization when notice is given if the check will be processed as an EFT transaction and the consumer completes the transaction. One of the proposed amendments would incorporate this commentary guidance into the regulation. ICBA supports this proposed modification.

Notice

Using its authority under section 904(d) of the EFTA, the Board is proposing to require that persons, merchants and other payees initiating ECK transactions provide explicit notice to consumers and obtain the consumer's authorization for each transaction in response to concerns about the uniformity and adequacy of some notices. Financial institutions initiating ECK transactions would also be subject to the proposed requirements. Only one authorization would be required for multiple checks submitted as payment for an invoice or received during a single billing cycle.

Acceptable clear and conspicuous notices would include generic signs or written statements at the point-of-sale, or provided on or with a billing statement or invoice. As proposed, the notice should include language advising consumers that when the transaction is processed as an EFT, funds may be debited from the consumer's account quickly and, as appropriate, notifying the consumer that the check will not be returned by the consumer's financial institution if the payee does not return the check to the consumer. The regulation would also be revised to include proposed safe harbor language for this notice.

Since payees or their intermediaries are making the decision to use ECK applications, ICBA supports the proposed uniform notice requirements. However, we believe it would be more accurate for the notice to state that funds

may be debited from the consumer's account **quicker or sooner.** Given the myriad of clearing paths and models for both paper checks and EFT transactions, the mere fact that a transaction is an ECK does not always result in faster clearing. Our recommended language would more accurately reflect market practices. The inclusion of language in the notice conveying that the consumer's financial institution will not return the check if the payee does not return the check to the consumer should reduce consumer confusion and the number of consumer inquiries made to financial institutions.

Consumer Authorization

The Board is seeking comments as to whether merchants or other payees should be required to obtain the consumer's written signed authorization to convert checks received at the point-of-sale. We concur that payees should require the consumer's written signed authorization to convert checks received at the point-of-sale. However, we oppose the Board incorporating this requirement in Regulation E, as we believe this issue is more appropriately addressed in the *NACHA Operating Rules*, as is the case today. Network rules, such as the *NACHA Operating Rules*, provide a forum to more timely address marketplace developments than Regulation E. Moreover, we believe that the omission of this provision in Regulation E would not cause harm to consumers since the *NACHA Operating Rules* already require the consumer's written signed authorization.

Disclosures

ICBA supports the proposed revision clarifying that a consumer gives authorization when the consumer proceeds with the transaction after receiving notice that an insufficient funds fee would be collected electronically.

The Board is also soliciting comments on whether a disclosure stating that a consumer authorizes an EFT, or in the alternative, a check transaction, may result in any consumer harm or create any other risks, and whether payees should specify the circumstances under which a check used to initiate an EFT will be processed as a check is appropriate. ICBA believes that the Board's proposed Regulation E requirements and provisions in the *NACHA Operating Rules* sufficiently apprise consumers of their rights and responsibilities with regard to ECK transactions and any impact on their checking accounts.

Any attempt by the Board to implement bright-line regulatory requirements for disclosing potential consumer harms and the circumstances under which a check may or may not be converted to EFT would bring innovation to a halt. Additionally, such a requirement would be contrary to the Board's objective of improving payment system efficiency by enabling banks to expand the use of electronics. This was the impetus for the Board proposing a new law, now known as Check 21. Banks and other payees, with proper notice to consumers, should have the flexibility to process, clear, and settle checks in the manner they

deem most efficient and cost effective. ICBA strongly opposes any such disclosure.

We support the proposed provision requiring specific reference to ECKs in initial disclosures. Although ICBA believes that many financial institutions are already in compliance with this proposed requirement, we request that the Board allow sufficient time for all financial institutions to implement this requirement.

Payroll Cards

The Board is proposing to extend Regulation E coverage to payroll cards that provide salary, wages, or other employee compensation on a recurring basis. Covered payroll card accounts would include those operated or managed by the employer, a third-party processor, or a financial institution. Cards used to disburse one-time bonuses, petty cash, or travel per diems would not be subject to the Regulation. Regulation E would apply whether funds are held in individual employee accounts or in a pooled account with subaccounts. The proposal would not apply to prepaid gift cards.

The Board's premise for extending Regulation E to certain payroll cards is based on its determination that these payroll cards involve an EFT to or from a consumer's account. Section 903(2) of the EFTA defines "an account" as "a demand deposit, saving deposit, or other asset account . . . as described in regulations of the Board, established primarily for personal, family, or household purposes. According to the Board, the EFTA's legislative history establishes clear Congressional intent that the definition of account is broader than traditional checking and savings accounts.

ICBA supported the Board's 1993 proposal to bring Electronic Benefit Transfer (EBT) programs within the scope of the EFTA's definition of "account", with certain modifications, to afford all consumers using EFTs to receive uniform protection under the EFTA and Regulation E. Federal EBT programs, and state and local employment-related EBT programs have similar characteristics to many payroll card programs. Both are assigned to an identifiable consumer, represent a stream of payments to a consumer, are replenished on a recurring basis and can be used in multiple locations for multiple purposes, use similar access devices, and involve EFT services.

ICBA supports extending Regulation E coverage to payroll card programs, with the modification discussed below, and exempting prepaid gift cards from Regulation E.

Periodic statements are not required if EBT programs make account information available to benefit recipients by other means – namely, telephone, electronic terminal or terminal receipt, and a two-month written account history upon request. ICBA recommends extending this same exemption to payroll card programs. This modification would avoid the costly and onerous burden of

requiring payroll card providers to supply periodic statements as long as other means are available. Failure of the Board to adopt this modification will have profound implications as the development and availability of payroll card programs will be stifled, depriving individuals without bank accounts a safe alternative for receiving and managing their payroll dollars.

ICBA disagrees with the Board's assertion that payroll card accounts are substitutes for traditional checking accounts. While many payroll card programs offer some of the same functionalities as traditional checking accounts, there are three important distinctions. First, payroll card programs do not permit check writing. Second, these programs do not permit deposits beyond the payroll deposit. Third, and most importantly, it is the employer or a third-party processor that is the financial institution's customer, not the employee. Consequently, ICBA believes that it is more appropriate for the Board to view payroll card programs as substitutes for cash or paper checks.

In response to the Board's inquiry as to whether six months following adoption of the final rule is sufficient for financial institutions to comply with the proposed revisions, ICBA urges the Board to adopt a one-year implementation time frame. An additional six-months is needed to provide all parties – financial institutions, employers, or third-party processors -- ample opportunity to ensure that processes are in place to comply with Regulation E.

ICBA requests that the Board clarify in its final rulemaking whether Regulation E would apply to programs where commissions are paid to consumers by a distributor on a recurring basis using stored value cards offering the same functionality as payroll card programs that would be subject to Regulation E under the Board's proposal. In this instance, the commission recipient -- frequently a consumer -- is not an employee, but an agent or independent contractor.

Basis for Determining Regulation E Coverage

The Board is also seeking comments on whether Regulation E coverage should be determined on the basis as to whether payroll card account funds qualify as "deposits" under section 3(1) of the Federal Deposit Insurance Act (FDIA). ICBA generally supports the convergence and streamlining of the legal and regulatory environment governing payments as innovation converges and creates new payment applications. However, the ICBA believes that it would be inappropriate for the Board to rely on the FDIA rather than the EFTA to trigger the applicability of Regulation E.

As noted earlier, the EFTA's legislative history established clear Congressional intent for the Board to apply Regulation E beyond traditional checking and savings accounts based on the payment account's functionality. The EFTA, not the FDIA, is the authorizing statute for Regulation E. Moreover, the Board's interpretation of the EFTA and Regulation E's applicability to new

payment applications as served all stakeholders well and ICBA sees no rationale in embracing the FDIA as a trigger for Regulation E applicability.

Issuance of Access Devices

The proposed revision to the Section 205.5 commentary would allow financial institutions to issue more than one access device in conjunction with the renewal or substitution of a previously accepted access device, provided the access device is not activated. ICBA supports this proposed modification as it provides financial institutions the flexibility to introduce new access devices to their customers without subjecting customers to additional risks.

Error Resolution

Financial Institution's Error Resolution Obligations

The proposed revision to the commentary is designed to provide additional guidance regarding the circumstances necessary for a financial institution to satisfy its error resolution obligations. Currently, a financial institution satisfies its error resolution obligations by reviewing its own records regarding the alleged transfer if the financial institution and the third party have no agreement for the type of EFT involved.

Under the proposed revision, a financial institution would not satisfy its error resolution obligations by merely reviewing the payment instructions if there is additional information within the financial institution that would assist in resolving the alleged error. According to the Board's example, this modification would require a financial institution to check ACH as well as demand deposit records in order to satisfy its obligations for resolution of alleged errors related to ECK transactions.

ICBA appreciates the Board's intent to provide additional guidance regarding the processes necessary for a financial institution to satisfy error resolutions obligations given payment applications' convergence and innovation. However, ICBA believes that the proposed guidance creates more ambiguity than clarity and requests that the Board revisit this provision and issue a revised proposal for comment. Alternatively, ICBA would be content for the existing guidance to remain in place, as ICBA is unaware of any data suggesting that the current process has disadvantaged consumers, financial institutions, or other parties to transactions. Moreover, ICBA urges the Board to remain mindful that financial institutions remain committed to the satisfactory resolution of alleged errors to preserve customer account relationships and their reputations.

Notice of Error from Consumer

ICBA supports the Board's proposed amendment clarifying that a financial institution does not have to comply with error resolution time limits and

provisional credit requirements if the consumer provides notice of an error more than 60 days after the financial institution sent the periodic statement that first reflected the alleged error.

Preauthorized Transfers

The Board is proposing to withdraw the commentary stating that a tape recording of a consumer telephone conversation authorizing a preauthorized debit does not constitute written authorization as it may conflict with the Electronic Signatures in Global and National Commerce Act (E-Sign Act). ICBA supports withdrawal of this provision in the commentary to eliminate this conflict. We believe that it is more appropriate for the *NACHA Operating Rules*, the rules governing ACH network transactions, to determine what constitutes a valid consumer authorization until the Board can make a definitive determination. ICBA encourages the Board to ascertain in a timely manner whether this type of authorization does indeed conflict with the E-Sign Act.

Additional proposed commentary revisions would: 1) allow a merchant to inquire whether a consumer's card used to authorize telephone or online charges is a debit or credit card; 2) clarify that a financial institution may use a third party to block recurring debits in which the consumer has placed a stop payment; and 3) permit financial institutions to provide consumers with a range of varying amounts for transfers, in lieu of providing notice with each varying transfer. ICBA supports the proposed revisions as they would reduce the number of exception transactions, facilitate compliance, and reduce regulatory burden.

Disclosures at ATMs

The proposed commentary revision would allow ATM signage to disclose that a fee *may* be imposed, in instances where all ATM users are not charged a fee for ATM usage or certain transactions. ICBA supports this modification as it reflects market practices and affords ATM operators the ability to accurately disclose their fees.

Conclusion

Again, ICBA appreciates the opportunity to comment on this important proposal. ICBA supports extending Regulation E to payroll card programs if there is an exemption for periodic statements paralleling the exemption for EBT programs. We also support exempting prepaid gift cards from Regulation E. It is inappropriate for the Board to rely on the Federal Deposit Insurance Act rather than the EFTA to trigger the applicability of Regulation E.

ICBA supports establishing uniform notice requirements with certain modifications for merchants and other payees initiating electronic check conversion transactions. We do not support incorporating a requirement that

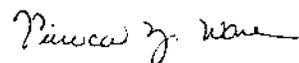
merchants obtain a consumer's signed written authorization for an ECK, as this should remain under the purview of the *NACHA Operating Rules*.

We also support a one-year implementation time frame for any modifications.

ICBA strongly encourages the Board to remain mindful of the importance of not adopting Regulation E provisions that would impair or halt the ability of financial institutions and payees to take advantage of the current innovative environment spurred by passage of Check 21.

If you have questions or need any additional information, please do not hesitate to contact me via telephone at (202) 659-8111, ext 2414 or email at viveca.ware@icba.org.

Sincerely,



Viveca Y. Ware
Director, Payments Policy