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WACHOVIA

BY ELECTRONIC AND OVERNIGHT MAIL

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

Electronic Address: reg.comments@federalreserve.gov

RE: Docket No. R-1220; Proposed Amendments to Regulation E

Ladies and Gentlemen:

This letter is submitted on behalf of Wachovia Corporation and its subsidiary companies, including Wachovia Bank, National Association, and Wachovia Bank of Delaware, National Association (collectively, "Wachovia"). Wachovia supports the efforts of the Board of Governors of the Federal Reserve System ("Board") in promulgating proposed amendments to Regulation E to address issues related to electronic checks and payroll cards. We believe, however, that certain parts of the proposed amendments to Regulation E and changes to the Official Staff Interpretations (collectively, "Proposal") may expose financial institutions to legal and compliance risks, without offering commensurate protection to consumers.

Electronic Check Conversion

Electronic check ("ECK") conversions are becoming widely used as a way to collect payments and reduce the number of checks presented through the clearing process. Creditors and merchants (collectively "merchants") receive some payments quickly, reducing the cost of funds in float. Issues related to lost or damaged checks and the cost of collection are reduced. Wachovia believes that both merchants and consumers ultimately benefit from the ECK process because merchants are able to control the costs of collection.

Regulation E coverage of electronic checks

In 2001, the Board addressed issues related to ECK conversion in the Official Staff Interpretations (“Commentary”) to Regulation E.¹ The Commentary describes the ECK process and addresses the issue of notice to the consumer. The Board recognizes that the National Automated Clearing House Association (“NACHA”) “requires merchants to obtain a written, signed or similarly authenticated authorization from the consumer for ECK transactions from the consumer’s account. The authorization must be readily identifiable as an authorization and must clearly and conspicuously state its terms.”² Although, Wachovia generally supports the Board’s proposal to address issues related to ECK transactions incorporated in the Regulation and other issues that have arisen since the Commentary, we respectfully submit the following comments.

Because concerns have been raised since the issuance of the Commentary regarding the uniformity and adequacy of notices being provided to consumers about ECK transactions, the Board proposes to bring merchants and other payees that initiate ECK transactions under Regulation E for the limited purpose of obtaining authorizations from consumers for ECK transactions. We agree that “a merchant or payee is in the best position to provide notice to a consumer”³ and that model notices will help bring uniformity and clarity to authorization process. We have concerns, however, about bringing merchants under the umbrella of Regulation E, even for the limited purpose of obtaining consumer authorization of ECK transactions. We urge the Board to make clear in the final regulation that the inclusion of merchants under Regulation E shall be solely for the limited purpose of obtaining authorization from consumers whose checks are processed through means other than the ordinary check clearing process. We further ask the Board to make clear that the authorization provisions will not have a cascading effect of requiring merchant compliance with other requirements of Regulation E, such as initial disclosures and error resolution.

Notice is effective consumer authorization

Under the Proposal, the notice authorizing an ECK transaction can be a generic statement posted on a sign or a written statement at a POS, or can be provided on or with a billing statement or invoice. The Board has solicited comment on “whether merchants or other payees should be required to obtain the consumer’s written signed authorization to convert checks received at POS.”⁴ Wachovia believes that such a requirement is unnecessary and may have over time a chilling effect on the use of ECK transactions by merchants and other payees. Wachovia, therefore, urges the Board to continue to allow the flexibility to provide the notice by sign or written statement at POS. Although NACHA currently requires such written authorization, flexibility in the Regulation would allow NACHA to change its requirements as consumers become more informed about, and comfortable with, ECK transactions.

¹ 12 C.F.R. 205.3(b)-3b3.

² 69 FR 56001 (September 17, 2004).

³ Ibid.

⁴ Ibid.

Many merchants who conduct POS ECK transactions obtain the customer's signature on payment vouchers. In most cases, the check is "read" by the electronic terminal; the consumer then signs the voucher. The voucher signifies consumer consent, but contains no information about transactions clearing more quickly or fees associated with dishonored transactions. Adding this additional information on signed payment vouchers will require that merchants have POS terminals reprogrammed. Merchants would be required to develop record retention and retrieval policies for signed receipts, producing these documents in the event of a consumer dispute. The cost to merchants would be significant, and compliance with the proposed regulation may take an extended period of time. If the Board should determine that signed authorizations at POS terminals are necessary, Wachovia requests that the Board delay mandatory compliance for a period of no less than 12 months from the effective date of the final regulation.

Wachovia believes that consumers who view posted notices at the POS terminals will be informed and protected without additional merchant costs. Therefore, Wachovia strongly supports the Board's proposed amendment to the Commentary that a notice to the consumer, posted at a terminal for point of sale ("POS") transactions, or included in a billing statement or other notice for ARC transactions, is sufficient to provide notice to the consumer of intent to conduct an electronic transaction. The submission of the check to be converted should be viewed as evidence of the consumer's consent to proceed with the transaction. No other authorization should be required.

Wachovia also strongly supports the Board's proposal that obtaining a single authorization for ARC transactions from the consumer holding an account is sufficient to convert multiple checks submitted as payment after receiving an invoice or during a single billing cycle, even if the checks are submitted by different makers. To require a different authorization to convert each check would be unduly burdensome, if not impossible.

Use of Model Clauses

The Proposal includes three model clauses that may be used for authorizing one-time electronic fund transfers using information from a check. Model clause A-6 (a) provides the merchant the most flexibility, allowing an item to be processed as an ECK or as a check. The Proposal does not clearly specify the circumstances under which model clauses (b) and (c) must or may be used, but suggests that the merchant or payee must use the option that best describes its individual practices. Wachovia requests that the Board state explicitly in Regulation E or in the Commentary that the use of Model Clause A-6 (a) for an ECK at a POS, in an ARC transaction, or for check processing would constitute sufficient notice to, and authorization from, the consumer.

Financial Institutions should not be required to amend initial disclosures

Wachovia has considered electronic checks to be electronic funds transfers since the Commentary to Regulation E was revised in 2001, and includes electronic checks in its Regulation E initial disclosures. Consumer periodic statements contain the proper description

of the transaction as required by §205.9(b); consumer disputes concerning ECKs are managed under the process described in §205.11. Wachovia does not believe that financial institutions should be required to amend initial disclosures to include additional detail that is applicable only to electronic check transactions, which are already covered by the Commentary to Regulation E.

The changes proposed in §205.7 and Appendix A would require financial institutions to destroy existing stock of preprinted disclosures and to notify existing customers of a change of terms.⁵ While a delay in the effective date of the regulation would allow financial institutions to deplete existing stock, the cost of reprinting and mailing will be significant. Wachovia believes that development, production, and mailing costs far exceed any consumer benefit of receiving a notice that explains a process that financial institutions have been following for several years. Therefore, we urge the Board to withdraw the proposed revision to §205.7 and the model clauses for initial disclosures in Appendix A.⁶ At a minimum, Wachovia requests that an effective date for the notice provisions required by proposed changes to §205.7 and Appendix A be no earlier than one year from the date that the final regulation is adopted.

Consumer Education is the key to understanding ECKs

The Board is concerned that consumers do not understand the process for electronic check conversion. Wachovia believes that consumer education, not regulation, is appropriate to address the issues related to shorter float time and the fact that checks are not returned in statements. Consumers should not regard “float” as a legal right to present checks for payment that are drawn on insufficient funds. Likewise, consumers do not have a legal right to have checks returned in their statements. Over the next several years, consumers will likely see many changes in the content of their demand deposit statements as banks convert checks to the Check 21 process.

The Board and the Federal Trade Commission (“FTC”) have championed the rights of consumers to understand financial transactions. Wachovia urges the Board to highlight consumer education to address the changes occurring in the electronic financial environment. Accordingly, we urge the Board to revise and republish its highly-informative pamphlet on electronic check conversions as promptly as possible.⁷

Payroll Cards

The Board, in proposing to amend §205.2(b)(1) of Regulation E to include payroll cards in the definition of an “account” covered by the entirety of the regulation, states that “payroll card products are, in effect, designed, implemented, and marketed as substitutes for

⁵12 C.F.R. 205.8 et seq.

⁶Model clauses A-2 and A-3 are proposed as revisions of initial disclosures and error resolution disclosures.

⁷69 FR 56001 (September 17, 2004).

traditional checking accounts at a financial institution.”⁸ Wachovia disagrees with this premise; we believe that payroll cards act as substitutes for *checks*, not as substitutes for accounts. Wachovia asks that the Board reconsider this issue and adopt amendments to Regulation E that would provide consumers using payroll cards the same protections as Electronic Benefit Transfers (“EBTs”).⁹

Payroll cards are substitutes for checks, not accounts

Payroll cards typically are marketed to employers as part of a menu of financial services that financial institutions offer to their commercial customers. The Board has recognized that “payroll cards have become increasingly popular with some employers, financial institutions, and payroll services providers.”¹⁰ Employers are attracted to the product for its convenience, efficiency and cost-reductions. Because more than 55% of Americans are paid by direct deposit, the cost savings of converting payroll accounts from traditional checks to electronic services may reach as high as 75%.¹¹

To be paid by direct deposit, however, an employee must first have a traditional bank account. Payroll cards are specifically designed as alternative electronic method of delivering paychecks to the “unbanked,” not as substitutes for banking accounts. In this connection, Wachovia notes the following two distinctions between a payroll card and traditional bank accounts.

First, demand deposit and other transaction accounts impose significantly greater risks and obligations on consumers and financial institutions than do payroll cards. Payroll cards have only “collected” funds paid into them via employer ACH transactions. Accounts, on the other hand, may have deposited items subject to dishonor and may contain uncollected funds. Consumers can write checks on accounts and find themselves in insufficient funds (“NSF”) situations, with checks returned unpaid, subjecting consumers to third-party NSF fees. This typically cannot occur with payroll cards. Depending upon bank policy, consumers may be able to overdraw accounts, and leave banks with negative balances; banks generally do not incur this risk with payroll cards. Financial institution accounts are subject to kiting and other instances of outright fraud, that very rarely happen with payroll cards.

Second, to mitigate these risks, many financial institutions “qualify” customers for demand deposit accounts in a manner similar to qualifying for some lending products. Conversely, a selling point of a payroll card to an employee is that they do not need to “qualify” for an account.

⁸ 69 FR 55999 (September 17,2004).

⁹ 12 C.F.R. 205.15, et seq.

¹⁰ 69 FR 55998 (September 17, 2004).

¹¹ Michele-Moore, Ariana. “Payroll Cards: A Direct Deposit Solution for the Unbanked,”

Celent Consulting Services, December 19, 2002.

Payroll card services are similar to the encashment of “on us” payroll checks. The customer presents the item (the card) and proper identification (a PIN, signature, and/or driver’s license, etc.) and the funds are disbursed in accordance with the instrument. Wachovia agrees with the Board that payroll cards are similar to debit cards, in that they offer the additional benefits of use for the purchase of goods and services at certain merchant locations or for withdrawing funds at automated teller machines (“ATMs”). However, these benefits do not cause payroll card services to rise to the level of a “consumer account.”

For these reasons, Wachovia urges the Board to withdraw its proposal to amend Regulation E that would deem the funds on a payroll card to be an “account” under §205.2(b)(1).

Payments made to payroll cards are similar to the payment of government benefits

In March 1994, the Board amended Regulation E to bring electronic benefit transfer (“EBT”) programs under the regulation.¹² The Board describes EBT as programs that are “designed to deliver electronic government benefits such as food stamps, supplemental security income (SSI), and social security . . . Eligible recipients receive magnetic-stripe cards and personal identification numbers and they access benefits through electronic terminals.”¹³

Payroll cards are substantially similar in their characteristics to electronic cards issued to citizens receiving government benefits. Payroll cards can more efficiently deliver funds to employees than checks by “reducing the cost of . . . delivery, facilitating the management of . . . funds, and helping to reduce fraud.”¹⁴ In addition, payroll cards offer employees immediate access to their wages without requiring the encashment of checks or requiring the employee to maintain an account at a financial institution. Financial institutions that administer EBT programs have the same relationship with the recipients of government benefits as they have with employees who are paid through payroll cards. The underlying contracts state the rights and responsibilities related to the receipt of funds and use of the card. These agreements do not contain the level of detail required for deposit accounts.

Consumers who hold EBT cards have similar protections under Regulation E as owners of debit cards. EBT cards represent electronic transfers for the purposes of §205.6 (liability for unauthorized transfers) and §205.11(error resolution procedures, with minor modification). The most significant difference between the “account” and the EBT card is that consumers do not have a right to receive a periodic statement under the EBT program. Instead, consumers have the right to request a limited account history by contacting the financial institution.¹⁵

¹² 59 FR 10678 (March 7, 1994).

¹³ 62 FR 43467 (August 14, 1997).

¹⁴ Ibid.

¹⁵ 12 C.F.R. 205.15(c)(2).

Wachovia believes that issuance and administration of payroll cards and EBTs are substantially similar and justify amending Regulation E to permit payroll cards to be issued and administered under the provisions of §205.15. In this regard, Wachovia recommends that (i) the proposed amendment of §205.2(b)(1)(3) be deleted from the Proposal; (ii) §205.15 be amended to provide, in its entirety, for the issuance and administration of payroll cards; and (iii) mandatory compliance with the requirements of §205.15 be delayed for a period of 12 months from the effective date of the final regulation.

Consumers would continue to have substantially all of the consumer protection rights under Regulation E, while financial institutions would be relieved from the burden of issuing periodic statements to holders of payroll cards. Experience from financial institutions currently employing these programs demonstrates both that the target audience is highly mobile, and that a large percentage of mailed periodic statements are returned because the addressee has moved. Further, “unbanked” consumers tend to prefer instant balance information, which they can receive at ATMs, by phone or online at public access terminals, rather than to wait for monthly statements. Requiring financial institutions to provide monthly statements would constitute an additional expense for a service that consumers with payroll cards typically do not want or need.

Regulation E coverage should not be determined by FDIC insurance coverage

The Board seeks comment on whether or not Regulation E coverage should be provided based on whether or not the underlying funds in a payroll card account are considered deposits. Wachovia does not believe that deposit insurance should be triggered by whether or not a card is deemed to be an “account” under Regulation E. The Federal Deposit Insurance Corporation (“FDIC”) recently sought comment on whether or not the underlying funds for payroll cards and other stored value cards should be afforded insurance coverage, and if so, and what party should be deemed to be the “insured.”¹⁶ In its response to the FDIC, Wachovia stated that the circumstances under which funds might be considered “insured deposits” might vary with the type and administration of the card account. Wachovia has urged the FDIC to consult with other bank regulators to determine whether or not action by a sister regulatory agency might impose unintended requirements on financial institutions. Wachovia supports the Board in its continuing dialogue with the FDIC on this issue.

Unsolicited Issuances

The Board proposes to amend the Commentary to permit issuers to issue additional access cards at the time of renewal or as substitutes for previously issued cards, if the new cards require consumer validation. Wachovia supports the Board’s position. The changes to the Commentary would allow issuers flexibility in issuing cards while protecting both consumers and issuers from fraud.

¹⁶ 69 FR 20558 (April 16, 2004).

Preauthorized Transfers

On April 4, 2001, the Board proposed interim rules concerning the application of the Electronic Signatures in Global and National Commerce Act (“E-Sign”) to Regulations B, E, Z and DD.¹⁷ At that time, the Board requested comment concerning the sufficiency of the statutory provisions relating to consumer consent to receive required disclosures. Wachovia submitted its response to the Board on May 31, 2001, stating, “§101(c) of E-Sign, which contains the consumer consent provisions, is one of the most problematic sections of the statute.” We noted from a public forum conducted by the FTC on April 3, 2001, that “it became clear that the consumer consent provisions of E-Sign were vague and subject to interpretation not only by regulators, but also by courts of appropriate jurisdiction.” Because this circumstance has not changed, financial institutions continue to struggle with the issue of electronic consumer consent.

Under the proposed amendment to the Commentary, the Board would remove the prohibition against telephone authorizations. By removing the clear prohibition against obtaining consent by telephone to effect an electronic fund transfer, the Board places financial institutions in an untenable position between their consumer customers and third parties that may be effecting these transfers. Under the current regulations, if a financial institution receives a complaint of an unauthorized transfer related to a telephone request, the financial institution requests the copy of the written authorization. In its absence, the transaction is reversed and the consumer’s account is credited.

While this may benefit the merchant conducting the transaction, it leaves the financial institution in a state of electronic confusion. The merchant may argue that a recorded telephone conversation is sufficient under E-Sign (which requires conditions other than simply the recording); the consumer may argue the merchant has not obtained the required authorization. The financial institution may find itself finalizing a provisional credit without recovery from the third party payee.

The contracting and fulfilling parties are in the best position to resolve such a dispute. By removing the language in the Commentary, the Board places financial institution in the position of arbiter. Wachovia urges the Board to reinstate its position that a telephone authorization, or a recording thereof, does not constitute a written authorization under Regulation E.

Notice of Transfers Varying in Amount

Wachovia supports the Board’s proposed amendment to §205.10(d)(2)-2 of the Commentary. Financial institutions offering consumers the option to transfer funds to an account at another institution would benefit from the cost savings derived from withholding notices of transfers

¹⁷ 66 FR 17779, et seq. (April 4, 2001).

within a range of balances. We are concerned that what may be considered an “acceptable range that can be anticipated by the consumer” may be difficult to interpret, but the related cost savings achieved by financial institutions may mitigate the risks associated with the proposal. Wachovia recommends that the Board further amend §205.10 (d)(2)-2 to provide examples of what the Board would consider “acceptable ranges of balances” that may excuse notice to the customer. Wachovia also suggests that Appendix A be amended to provide optional language that may be used to comply with the Proposal.

Notice of Error from Consumer

Wachovia supports the Board’s proposed amendment of §205.11(b) to the Commentary. Financial institutions have struggled with issues arising from liability for unauthorized transactions when notices of errors are stale-dated. Because of ambiguity in the current Regulation, many financial institutions have applied the same standard to stale-dated unauthorized transaction complaints as they have applied to other types of error notices. Wachovia applauds the Board’s action to clarify for financial institutions, consumers and the courts the obligations applicable to stale-dated complaints.

Investigation of Complaints

While Wachovia generally agrees with the principles proposed in the addition of §205.11(c)(4)-5 to the Commentary, we are concerned that the language is vague and may impose unintended, adverse consequences on financial institutions. In general, financial institutions use the information available in its electronic funds systems to respond to inquiries about transactions. Where an unauthorized transaction is alleged, Wachovia, for example, will examine the underlying circumstances of the claim. Where fraud is evident, the matter is resolved promptly. When appropriate, the matter is referred to law enforcement authorities.

The Commentary, and the Board’s accompanying explanation, implies that financial institutions may be obligated to examine additional circumstances and make judgment calls about the effect of these facts on the transaction. The Board suggests that financial institutions may be required to review other facts, such as whether or not a check that may be related to the transaction is a “check out of sequence” or whether or not there may have been prior transactions between the drawer and the payee. Neither of these would conclusively determine whether or not fraud has occurred, and in many cases this information may not be available to the financial institution. The proposed Commentary thus appears to require a higher standard of investigation for error resolution processes than that which financial institutions generally perform today.

Accordingly, Wachovia requests that the Board withdraw this modification to the Commentary. We believe that current error resolution processes work well, and that placing additional, subjective requirement on financial institutions will impose significant and unnecessary burdens without commensurate consumer benefits.

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Disclosures at Automated Teller Machines

Wachovia supports the Board's proposal to allow financial institutions and ATM owners to post flexible language on the face or screen of ATMs. Customers and non-customers of the ATM owner use ATMs for an increasing number of diverse transactions. The user and the use of the machine govern whether or not a fee is imposed for a particular transaction. The proposed language of §205.16(b)(1) allows the owner flexibility without limiting the right of the consumer to anticipate the cost of the transaction.

Wachovia appreciates the opportunity to comment on this Proposal and we hope that the Board will find these views helpful. If you have any questions, please contact Jane Stafford, Director of General Bank and Specialty Finance Compliance, at (704) 383-0927.

Very truly yours,

Michael A. Watkins