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November 29, 2004

Board of Governors of the  
Federal Reserve System  
Washington, D.C. 20551

Attention: Jennifer J. Johnson, Esq.  
Secretary

Re: Docket No. R-1210 - Proposed  
Revision to Regulation E

Governors:

The Clearing House Association L.L.C. (The Clearing House)<sup>1</sup>  
is pleased to comment on the Board's proposal to amend its  
Regulation E and the official staff commentary.<sup>2</sup>

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<sup>1</sup> Formerly called The New York Clearing House Association L.L.C. The members of The Clearing House are: Bank of America, National Association; The Bank of New York; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; LaSalle Bank National Association; U.S. Bank, National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association. The following members of The Clearing House's affiliate, The Clearing House Payments Company L.L.C., also took part in the preparation of this letter and endorse its positions: Branch Banking and Trust Company; Comerica Bank; KeyBank, National Association; and Manufacturers and Traders Trust Company.

<sup>2</sup> 69 Fed. Reg. 55,996 (Sept. 7, 2004).

The proposed changes would resolve outstanding issues regarding the coverage of electronic check conversion services, requiring merchants and others that convert consumer checks to electronic debits to obtain the consumers' authorization for the debits. The amended rule would also extend its coverage to payroll card accounts, and amendments to the regulation and revisions to the staff commentary would clarify the Board's position on a number of important issues arising under Regulation E.

#### Electronic Check Conversions

The Board proposes to extend the coverage of Regulation E to merchants and other payees for the limited purpose of requiring the party that initiates a one-time electronic-funds transfer using information from a consumer's check to obtain the consumer's authorization for the transfer. This would entail a requirement that the consumer be notified of the transaction and that authorization is being solicited. The Board states that the purpose of the proposal is to enhance the accuracy, consistency, and clarity of the notices that consumers receive when their checks are being converted to electronic debits, correcting the deficiencies that the Board has found in the current notices.<sup>3</sup>

While we agree that persons who use checks to create electronic debits to consumer accounts should be required to

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<sup>3</sup> Id. at 56,000.

notify a consumer of what is happening and to obtain the consumer's authorization to initiate the debit, regulation may not be the best way to impose this requirement. Merchants and other persons who use information from checks to create ACH debit entries are already subject to similar requirements under the Operating Rules of the National Automated Clearing House Association ("NACHA Rules"). Under these rules, the receiver (i.e., the person whose account is to be debited) must authorize the originator (the person initiating the debit entry) to initiate the entry to the receiver's account. In the case of debit entries to a consumer account, this authorization must be in writing, signed or similarly authenticated by the consumer, and be readily identifiable as an authorization.<sup>4</sup> Where a check is used as a source document for an ACH debit entry initiated at the point of purchase (a "POP entry"),<sup>5</sup> the NACHA Rules also require that the consumer be given a receipt that contains specified information.<sup>6</sup> Where the payee (or a financial institution acting as the payee's agent) converts a check

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<sup>4</sup> NACHA Rules § 2.1.2.

<sup>5</sup> The NACHA Rules define a POP entry as a single-entry debit initiated by the use of a source document (such as a check or share draft) provided by the receiver to the originator at the point of purchase. Id. §§ 13.1.42, 3.7.1.

<sup>6</sup> Id. § 3.7.3.

received at a lockbox to an ACH debit (an "ARC entry"),<sup>7</sup> the authorization consists of a notice to the consumer that receipt of a check at the lockbox is considered to be authorization to initiate an ACH debit.<sup>8</sup>

The requirements that the NACHA Rules place on originators of ACH debits that use a consumer's check as a source document are consistent, and in some respects go beyond, what the Board has proposed. Moreover, they represent the best judgment of the banking community, with advice from merchants and other interested parties,<sup>9</sup> on how to protect their customers from fraudulent or abusive transactions. The Board and the Federal Reserve Banks also participate in NACHA meetings and, although they have no formal vote on NACHA rules, exercise considerable influence on the NACHA rule-making process.

We believe that private-sector rules may be a more appropriate vehicle for establishing standards for obtaining customer authorization. Compared to private-sector rules,

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<sup>7</sup> The NACHA Rules define an ARC entry as a single-entry debit initiated by an originator to a consumer account pursuant to a source document provided to the originator through the mail or at a drop box. Id. § 13.1.6.

<sup>8</sup> Id. §§ 2.1.2, 2.1.4.

<sup>9</sup> NACHA's voting members are banks and regional ACH associations, like The Clearing House. Merchants and others that serve consumers participate in the NACHA rule-making process through membership in NACHA councils and rules work groups, but do not have a formal vote on proposed changes to the NACHA Rules.

federal regulations are inflexible and less easily adapted to meet changing circumstances. A case in point is the question of whether a merchant that uses a consumer's check as a source document for an ACH debit to the consumer's account should obtain the consumer's written signature or its legal equivalent. This is currently a requirement of the NACHA rules<sup>10</sup> and the Board has requested comment on whether it should be incorporated into Regulation E.<sup>11</sup> We believe that merchants should obtain the consumer's signature: it gives the consumer a clear understanding of what is happening to his check and helps to protect the merchant and the banks involved from possible misunderstanding or confusion on the customer's part. But as merchants are already required to obtain the consumer's signature, a regulatory requirement that they do so will be redundant. Furthermore, the private-sector rule will be more flexible and will be able to be changed more quickly if other, secure methods of authentication become available or if check conversions become so routine that less stringent authentication methods become appropriate. Because of these factors, we do not support incorporating into Regulation E a requirement that merchants obtain a consumer's signature before converting a consumer's check to an ACH debit entry at the point of purchase.

The Clearing House strongly supports the proposal to apply the authorization to all checks provided for a single payment or

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<sup>10</sup> NACHA Rules § 2.1.2.

<sup>11</sup> 69 Fed. Reg. at 56,000.

invoice.<sup>12</sup> Consumers frequently use two or more check for a single payment or invoice: for example a husband and wife may provide separate checks for their respective portions of a single credit card bill. If the consumer's authorization did not apply to all checks included in the payment, then, as a practical matter, none of the checks in the package could be converted as it would be impossible to determine which individual checks could be converted and which could not.

The Clearing House takes exception to proposed section 205.3(b)(2)(iii). This would require persons initiating an ACH debit to provide a notice to the consumer that states that "when a check is used to initiate an electronic funds transfer, funds may be debited from the consumer's account quickly," the implication being that a check that is converted to an electronic debit will be posted more quickly than if it were collected through the check clearing system. This statement is no longer factually correct. In many cases, the drawer's account is charged on the basis of an electronic presentment notice, which often arrives at the payor bank at the same time or before an electronic funds transfer would arrive. In the future, many checks will be converted to substitute checks or images, and Check 21 is likely to usher in an age of rapidly collected checks. It is no longer true that ACH debits reach the payor's account faster than checks. Consumers ought not to be given notices that imply the contrary.

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<sup>12</sup> Proposed 12 C.F.R. § 205.3(b)(2)(ii).

The Clearing House believes that it would be appropriate to provide consumers with some notice that would inform them that checks may, in the alternative, be collected as checks or converted to electronic debits. We would not, however, require that the disclosures specify the circumstances under which these alternative processing paths may be selected. New electronic-check proposals are proposed with great frequency, and Check 21 is sure to open up new avenues for processing checks. Because of these factors, the circumstances under which a check will be collected as such and when it will be converted to an electronic debit are in a state of flux, and any notice that tried to describe the circumstances with any specificity would become obsolete very quickly and therefore be subject to constant revision. A general notice alerting consumers to the possibility that checks may be either collected or converted should be sufficient.

With respect to disclosures to be made by financial institutions, disclosures to new customers could be revised relatively quickly, but disclosures to existing customers could take longer. We suggest that the Board provide an implementation period of at least twelve months from the date that the final rule is published in the Federal Register.

We believe that the language in proposed section 205.3(b)(2)(i) may be too broad. The proposed language provides that Regulation E "applies where a check, draft, or similar paper instrument is used as a source of information to initiate a one-time electronic fund transfer from a consumer's account." This

language fails to limit the coverage to those instances in which a consumer has provided a check solely for the purpose of initiating an electronic fund transfer. Because check images or electronic information (e.g., information from the MICR line) are created using a paper check as a "source of information," the broad language proposed by the Board could result in Regulation E coverage of transactions arising from the exchange of electronic information drawn from a check or an electronic image of a check when such information or image is transmitted to the payor bank through an electronic file. Electronic check presentment transactions are normally governed by "agreements for electronic presentment" under section 4-110 of the Uniform Commercial Code (1994 official text), or by agreements, clearing-house rules, or similar arrangements that vary the provisions of Article 4 (for those states that still have earlier versions of Article 4 in effect). The language proposed by the Board for section 205.3(b)(2)(i) may inadvertently bring presentment notices under such agreements within the purview of Regulation E, and banks would not have a bright line to determine when U.C.C. coverage ends and Regulation E coverage begins. We doubt that the Board intended this result. We therefore recommend an amendment to the text of Regulation E or the commentary to the effect that Regulation E does not apply to items or checks presented under a presentment notice under section 4-110 of the Uniform Commercial Code or by agreements, clearing-house rules, or similar arrangements that vary the provisions of Article 4.

### Payroll Cards

The Board proposes to amend Regulation E to cover payroll card accounts established by employers on behalf of consumers to receive recurring deposits of wages, salary, or other employee compensation.<sup>13</sup> The Clearing House believes that payroll card accounts are very similar to electronic benefit card accounts ("EBT accounts") that governments provide to recipients of government-benefit programs that do not have bank accounts. The Board has already established a set of rules in Regulation E to govern EBT accounts,<sup>14</sup> and we believe that it would be more appropriate for the Board to adapt these rules to payroll accounts than to treat them as ordinary bank accounts for purposes of the regulation.

Whatever the decision regarding Regulation E treatment of payroll card accounts the Board makes, The Clearing House banks do not agree that six months after the adoption of the final rule would be a sufficient amount of time for all issuers to come into compliance. We suggest that twelve months is a more realistic implementation period.

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<sup>13</sup> Proposed 12 C.F.R. § 205.2(b)(3); see also 69 Fed. Reg. at 55,998.

<sup>14</sup> See 12 C.F.R. § 205.15.

Error Resolution

The Board proposes to amend the official staff commentary to clarify the "four-walls rule," which states that an institution may limit its investigation to a review of its own records. Under the new interpretation, an institution's own records will include any information available within the institution, not just information that was generated by the institution. The Clearing House banks generally do not limit their inquiries to the payment instructions and will consider other information that is available to the bank employee who is in charge of the investigation. Nevertheless, a requirement that a bank "must review all information within the institution's own records relevant to resolving the consumer's particular claim," is overly broad and undefined, potentially leaving banks in the dark as to how far their obligation to investigate really goes. Banks today are large and complex organizations and may have many different relationships with a single consumer; the bank employee doing the investigation may not know about all of these relationships and may not have any practical way of obtaining all of the information about the bank's dealings with the consumer. And this does not even consider the possibility that other affiliates within the same holding company may have relationships with the consumer that cannot be shared under various privacy statutes. Any reasonable interpretation of the four-walls rule must limit the bank's duty to inquire not just to "information within the institution's own records relevant to resolving the consumer's particular claim," but to information that is reasonably

available to the bank employee responsible for investigating the consumer's claim.

The Board has also requested comment on "whether there are circumstances in which the 'four walls' rule should not apply."<sup>15</sup> The Clearing House believes that requiring a bank to obtain information from other parties to the transaction, would be extremely burdensome. Records of transactions that are covered by Regulation E (e.g., ACH entry records) will almost always contain sufficient information for a bank to tell its customer who originated the transaction, whether the transaction can be reversed, whether the consumer's liability for the transaction is limited by law, whether the customer must seek redress directly with originator, and whether other avenues for resolution are available. There is no need to require banks to conduct burdensome investigations outside of their own records.

#### Other Issues

Preauthorized Transfers. The Clearing House supports the proposal to amend comment 10(b)-7 to clarify that asking a customer to specify whether a card being used to authorize a transaction is a credit card or a debit card is a procedure that is reasonably designed to avoid inadvertently violating the Regulation E requirement to obtain written authorization when a debit card is used for recurring payments.

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<sup>15</sup> 69 Fed. Reg. at 56,005.

Issuance of Access Devices. The Clearing House supports new proposed comment 5(b)-5, which would clarify the "one-for-one rule" by stating that financial institutions may issue more than one access device during renewal or substitution of a previously accepted device provided they comply with the conditions set out in section 205.5(b) for the additional access devices.

ATM Disclosures. The Clearing House also strongly supports the Board's proposal to revise comment 16(b)(1)-1 to make it clear that the notice at an ATM may disclose that a fee "may" be charged for certain transactions if the ATM operator imposes fees on some, but not all of, the ATM's users. If the operator always charges a fee, the sign must disclose that a fee "will" be imposed. Nevertheless, we believe that the Board should grandfather existing signs at ATM locations. Large banks have many thousands of ATM signs, and changing them all to fit a new regulatory requirement would be prohibitively expensive. Signs at ATM locations are intended to give consumers a general notice, while the notice that comes up on the screen gives more specific details. As long as the notice on the screen accurately reflects what is actually happening, existing location signs should continue to be acceptable.

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We hope these comments are helpful. If you have any questions, please call Joseph R. Alexander, Senior Counsel, at 212-612-9334.

Very truly yours,

A handwritten signature in cursive script, appearing to read "J. Alexander", with a horizontal line underneath the name.