

FEDERAL RESERVE SYSTEM

12 CFR Part 205

[Regulation E; Docket No. R-1007]

Electronic Fund Transfers

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule; technical amendments.

SUMMARY: The Board is publishing for comment a proposed rule to eliminate the extended time periods in Regulation E for investigating claims involving point-of-sale (POS) debit card and foreign-initiated transactions. Regulation E implements the Electronic Fund Transfer Act. Financial institutions generally have up to 10 business days to provisionally credit an account and up to 45 calendar days to complete an investigation of an alleged error. For POS and foreign transactions, financial institutions have up to 20 business days under the regulation to provisionally credit an account and up to 90 calendar days to complete the investigation of an alleged error. The Board believes that technological improvements in payment systems should permit consumer claims of error to be investigated more quickly than in the past, and proposes to amend the regulation accordingly. The proposed rule also contains a technical amendment to a model form to harmonize it with the regulation.

DATES: Comments must be received on or before May 15, 1998.

ADDRESSES: Comments should refer to Docket No. R-1007, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building Courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Except as provided in the Board's Rules Regarding Availability of Information (12 CFR 261.12), comments will be available for inspection and copying by members of the public in the Freedom of Information Office, Room MP-500 of the Martin Building, between 9:00 a.m. and 5:00 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Obrea O. Poindexter, Staff Attorney, or John C. Wood, Senior Attorney, Division of Consumer and Community Affairs, Board of Governors of

the Federal Reserve System, at (202) 452-2412 or (202) 452-3667. For users of Telecommunications Device for the Deaf (TDD) only, contact Diane Jenkins at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Background

The Electronic Fund Transfer Act (EFTA), 15 U.S.C. 1693 et seq., enacted in 1978, provides a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer (EFT) systems. The Board's Regulation E (12 CFR Part 205) implements the act. Types of transfers covered by the act and regulation include transfers initiated through an automated teller machine (ATM), point-of-sale (POS) terminal, automated clearinghouse, telephone bill-payment system, or home banking program. The rules prescribe restrictions on the unsolicited issuance of ATM cards and other access devices; disclosure of terms and conditions of an EFT service; documentation of EFTs by means of terminal receipts and periodic account statements; limitations on consumer liability for unauthorized transfers; procedures for error resolution; and certain rights related to preauthorized EFTs.

II. Proposed Regulatory Revisions

Error Resolution--POS Transactions

The EFTA requires a financial institution to investigate and resolve a consumer's claim of error--for an unauthorized EFT, for example--within specified time limits. Within 10 business days after receiving notice of an alleged error an institution must either resolve the claim or provisionally credit the consumer's account while continuing to investigate. In the latter case, the institution must resolve the claim no later than 45 calendar days after receiving notice.

For POS and foreign transactions, Regulation E provides longer time periods; it allows 20 business days to resolve a claim of an error (or to provisionally credit an account if the investigation takes longer), and 90 calendar days to complete the investigation. The rule allows issuers to avoid having to provisionally credit an account before the investigation is complete. The longer periods were adopted by the Board in 1982 for foreign transactions; and were adopted in 1984 for POS transactions, along with amendments to Regulation E to cover paper-based debit card transactions. Initially, the Board proposed to have the longer time periods for resolving claims of error apply only to paper-based debit card transactions (at merchant locations) that did not involve electronic terminals. After public comment, the Board adopted a final rule that applied the extended time frames to all POS transactions. The adoption of a uniform rule avoided the complexity of having the timing rules depend on how the particular EFT was initiated, which would have been confusing to consumers and burdensome to institutions. Moreover, at that time only a small portion of the POS debit card transactions involved electronic terminals.

The use of electronic terminals for all types of POS debit card transactions is now commonplace. Debit card transactions using personal identification numbers (PINs) at grocery stores and other merchant locations (referred to as PIN-protected) have been the most common type of debit card transaction in the United States. In the past few years, however, there has been an increase in the use at POS terminals of debit cards that can be used without a PIN (commonly referred to as check cards). Besides making them available upon request, many institutions have automatically replaced their customers' existing PIN-protected cards with cards that can be used with a PIN or without a PIN depending on where the transaction takes place.

This development has raised concerns about the potentially greater consumer exposure to losses in the absence of PIN protection. On September 24, 1997, the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Banking and Financial Services held a hearing on two bills to amend the EFTA in connection with the use of check cards. The bills would limit consumer liability for check cards, restrict unsolicited issuance of the cards in substitution for PIN-protected cards, add disclosures, and require institutions to provisionally recredit accounts sooner while investigating claims of unauthorized use or other errors.

With regard to the investigation of claims of error, legislation was introduced that would require institutions to recredit a consumer's account within three business days of notice of the claim of error. An industry representative of a card association testified that standards were voluntarily being adopted to require member institutions to provisionally credit accounts involving the use of a check card within five business days.

The Board believes that technical improvements in the payment system should permit consumer claims involving POS transactions to be investigated more quickly for transactions at POS; the same may be true for foreign transactions as well. Testimony at the September 1997 congressional hearing supports that conclusion. The Board believes that, especially in the context of accounts that can be accessed without PIN protection (potentially increasing consumer exposure to losses), the importance of more prompt recrediting of consumers' funds pending investigation may outweigh the compliance burden, if any, associated with this change. Therefore, the Board proposes to eliminate the extended time periods for POS and foreign transactions. The Board solicits specific comment on whether removal of the special rule would impose an undue burden.

Error Resolution--New Accounts

In the course of the Board's review of Regulation E, financial institutions suggested a change in the error resolution requirements when a new account is involved. The problem arises when individuals open an account with the intent to defraud. Such individuals may open an account, immediately withdraw all or a large portion of the funds through ARMS, and file a claim

with the financial institution disputing the ATM transactions. Often they receive provisional credit because of the financial institution's inability to research the claim (such as by obtaining photographic evidence from a nonproprietary ATM) within ten business days of a claim. At that point, the individual immediately withdraws the funds that were provisionally credited and abandons the account. Institutions believed that having more time to investigate errors involving new accounts would enable them to limit their losses and control this type of fraud.

The Board proposed in May 1996 to amend Regulation E, pursuant to its section 904(c) authority to provide for adjustments and exceptions in the regulation, to extend the error-resolution time periods for new accounts. The proposal would have allowed 20 business days for resolving an error before an institution is required to provisionally credit, and an outside limit of 90 calendar days for resolving the claim. The Board solicited comment on the extensions of time, on the 30-day definition for new accounts, and on whether consumer protections relating to error resolution would be adversely affected.

Comments on the proposed rule, from financial institutions and trade associations, were generally favorable. However, in light of the proposed rule to reduce the time for resolving errors involving POS and foreign transactions, the Board is deferring final action until action is taken on the POS and foreign transaction proposal.

Technical Amendment to Error Resolution Notice

Regulation E requires financial institutions to investigate and resolve errors alleged by consumers, either within 10 business days after receiving the consumer's notice of error or within 45 calendar days after receiving the notice, provided the institution provisionally credits the consumer's account within 10 business days. Upon completion of the investigation, the institution must notify the consumer of its findings. Prior to the 1996 revision of Regulation E, the institution had an additional three days to notify the consumer only if the institution found that an error did not occur and was operating under the 45-day rule. If the institution found that an error did occur, the institution was required to notify the consumer no later than the tenth business day or the 45th calendar day, as applicable.

In the 1996 revision, the Board amended the error resolution procedures (§ 205.11) to allow institutions the three additional days to notify the consumer in all cases. However, the model error resolution notice (Appendix A, paragraph A-3) was not revised at that time to conform to the amendment to § 205.11. The text of the model notice is being amended to conform it to § 205.11 as amended.

III. Form of Comment Letters

Comment letters should refer to Docket No. R-1007. The Board requests that, when possible, comments be prepared using a standard typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text into machine-readable form through

electronic scanning, and will facilitate automated retrieval of comments for review. Comments may also be submitted on computer diskettes, using either the 3.5" or 5.25" size, in any DOS-compatible format. Comments on computer diskettes must be accompanied by a paper version.

IV. Regulatory Flexibility Analysis

In accordance with section 3(a) of the Regulatory Flexibility Act, the Board's office of the Secretary has reviewed the proposed amendments to Regulation E. The Board believes that the proposal to shorten the time period for investigating errors alleged in point-of-sale debit card transactions will provide increased consumer protection without any increase in regulatory burden. The current exception to the statutory requirement of 10 business days for such investigations was implemented at a time when paper-based transactions were more common. The Board believes that such transactions are uncommon today, beyond the initial deposit of transaction information when depository institutions and third-party processors convert any paper-based information to electronic form. The Board specifically solicits comment on extent of any difficulty that this change might warrant.

V. Paperwork Reduction Act

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the interim rule under the authority delegated to the Board by the Office of Management and Budget.

The Federal Reserve has no data with which to estimate the burden the proposed revised requirements would impose on state member banks. Issuers would be able to use electronic communication to provide disclosures and other information required by this regulation rather than having to print and mail the information in paper form. The use of electronic communication may reduce the paperwork burden of financial institutions or merely may reduce the dollar cost.

The Federal Reserve requests comments from issuers, especially state member banks, that will help to estimate the number and burden of the various disclosures that would be made in the first year this interim regulation is effective. Comments are invited on: (a) whether the proposed revised collection of information is necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; (b) the accuracy of the Federal Reserve's estimate of the burden of the proposed revised information collection, including the cost of compliance; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology. Comments on the collection of information should be sent to the Office of Management and Budget, Paperwork Reduction Project (7100-0200), Washington, DC 20503, with copies of such comments sent to Mary M. McLaughlin, Chief, Financial Reports Section, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551.

The collection of information requirements in this interim regulation are found throughout 12 CFR Part 205 and in Appendix A. This information is mandatory (15 U.S.C. 1693 *et seq.*) to ensure adequate disclosure of basic terms, costs, and rights relating to electronic fund transfer (EFT) services provided to consumers. The respondents/recordkeepers are for-profit financial institutions, including small businesses. Institutions are also required to retain records for 24 months as evidence of compliance.

The Board also proposes to extend the Recordkeeping and Disclosure Requirements in Connection with Regulation E (OMB No. 7100-0200) for three years. The current estimated total annual burden for this information collection is 462,839 hours, as shown in the table below. These amounts reflect the burden estimate of the Federal Reserve System for the 851 state member banks estimated to be covered by Regulation E. This regulation applies to all types of issuers, not just state member banks. However, under Paperwork Reduction Act regulations, the Federal Reserve accounts for the burden of the paperwork associated with the regulation only for state member banks. Other agencies account for the paperwork burden for the institutions they supervise.

	<i>number of respondents</i>	<i>estimated annual frequency</i>	<i>estimated response time</i>	<i>estimated annual burden hours</i>
Initial Disclosures				
Initial terms	851	250	2.50 minutes	8,865
Change in terms	851	340	1.00 minute	4,822
Transaction disclosures				
Terminal receipts	851	71,990	0.25 minute	255,265
Deposit verifications	851	420	1.50 minutes	8,936
Periodic disclosures	851	12,800	1.00 minute	181,547
Error resolution rules	851	8	30.00 minutes	3,404
<i>Total</i>				<u>462,839</u>

Since the Federal Reserve does not collect any information, no issue of confidentiality normally arises. However, the information may be protected from disclosure under the exemptions (b)(4), (6), and (8) of the Freedom of Information Act (5 U.S.C. 522 (b)). The disclosures and information about error allegations are confidential between the institution and the consumer. An agency may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid OMB control number. The OMB control number for the Recordkeeping and Disclosure Requirements in Connection with Regulation E is 7100-0200.

List of Subjects in 12 CFR Part 205

Consumer protection, Electronic fund transfers, Federal Reserve System, Reporting and recordkeeping requirements.

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed changes to Regulation E. New language is shown inside bold-faced arrows, while language that would be removed is set off with brackets.

Pursuant to the authority granted in sections 904(a) and (c) of the Electronic Fund Transfer Act, 15 U.S.C. 1693b(a) and (c), and for the reasons set forth in the preamble, the Board proposes to amend Regulation E, 12 CFR Part 205, as set forth below:

Part 205 -- ELECTRONIC FUND TRANSFERS (REGULATION E)

1. The authority citation for Part 205 continues to read as follows:

Authority: 15 U.S.C. 1693-1693r.

2. Section 205.11 would be amended by removing paragraph (c)(3) and redesignating paragraph (c)(4) as (c)(3).

3. In Appendix A to Part 205, in A-3 MODEL FORMS FOR ERROR RESOLUTION NOTICE (§§ 205.7(b)(10) and 205.8(b)), the undesignated second and third paragraphs following paragraph (a)(3) would be revised to read as follows:

(a) Initial and annual error resolution notice (§§ 205.7(b)(10) and 205.8(b)) ****

We will <determine whether an error occurred= [tell you the results of our investigation] within 10 business days after we hear from you and will correct any error promptly. If we need more time, however, we may take up to 45 days to investigate your complaint or question. If we decide to do this, we will credit your account within 10 business days for the amount you think is in error, so that you will have the use of the money during the time it takes us to complete our investigation. If we ask you to put your complaint or question in writing and we do not receive it within 10 business days, we may not credit your account.

<We will tell you the results of our investigation within three business days after completing it.= If we decide that there was no error, <this will include= [we will send you] a written explanation [within three business days after we finish our investigation]. You may ask for copies of the documents that we used in our investigation.

By order of the Board of Governors of the Federal Reserve System, March 12, 1998.

 (Signed)
William W. Wiles,
Secretary of the Board.