



November 18, 2004

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

Re: Docket No. R-1210  
Electronic Fund Transfers  
Proposed rule; official staff interpretation

Dear Ms. Johnson:

The Association for Financial Professionals (AFP) welcomes the opportunity to respond to the Federal Reserve Board's request for comment on proposed amendments to Regulation E that would address its coverage of electronic check conversion services and those providing the services. In addition, the amendments would provide that payroll accounts are "accounts" covered by Regulation E.

AFP represents approximately 14,000 finance and treasury professionals who, on behalf of over 5,000 corporations and other organizations, are significant participants in the payments system. Organizations represented by its members are drawn generally from the Fortune 1,000 and the largest of the middle market companies. Many of AFP's members are responsible for policies and procedures governing the receipt of check and ACH payments by their organizations, as well as for decisions regarding the issuance of payroll cards. They thus have a sizable stake in the adoption of regulations that protect and promote the efficiency and safety of electronic fund transfers.

### **Electronic check conversion services**

Electronic payments—debit and credit cards and automated clearing house (ACH) transactions—have become the consumer's payment method of choice, accepted for their convenience, speed and efficiency. However, consumers have raised concerns about one electronic payment application—electronic check conversion.

In an electronic check conversion (ECK) transaction, the consumer writes a check that becomes the source of information to initiate a one-time electronic fund transfer (EFT). The consumer authorizes the EFT when he/she receives notice that the transaction will be processed as an EFT and goes forward with the transaction (generally termed "notice=authorization"). Consumers have complained that these notices are hard to understand, not readily noticeable, and not uniformly worded.

The Federal Reserve's provisions on ECK transactions are currently included in the Official Staff Commentary to Regulation E. Under the proposed rule, provisions would be contained in the regulation itself and in the Official Staff Commentary.

AFP supports the objectives of the Federal Reserve's proposed ECK amendments, which would:

- Provide greater clarity and consistency to the consumer notice about authorizing an ECK transaction, and
- Afford merchants and other payees increased flexibility in processing payments.

Greater consumer understanding of the ECK process will facilitate acceptance and offer advantages to payees by reducing customer service inquiries, enhancing payments efficiency and lowering costs.

### **Payroll cards**

AFP members' companies view payroll cards as an efficient electronic funds distribution mechanism for payroll and related functions. Payroll cards are a valuable corporate tool for migrating from check to electronic payments and achieving an all-electronic payroll. They have proven to be effective in reaching the unbanked and those who do not enroll in direct deposit of payroll.

AFP supports the objective of increased consumer protection for payroll cards. However, AFP has serious concerns about defining employers as "financial institutions" for purposes of Regulation E.

### **Summary of AFP recommendations**

AFP's comment letter to the Federal Reserve offers the following recommendations:

- AFP agrees with the proposal to cover merchants and other payees under Regulation E for the purpose of obtaining authorizations for ECK transactions, but recommends modifications to the model clauses used in the payee notification to consumers.
- AFP agrees with the proposal to allow payees to use the information from a check to initiate an EFT or, alternatively, to process the item as a check, but does not believe that payees should be required to specify the circumstances under which a check will be processed as a check.
- AFP approves of the proposed change to notice=authorization for point-of-sale transactions and for insufficient funds fees, with recognition that payment network rules may impose additional authorization requirements.
- AFP agrees with the proposal to cover payroll cards under Regulation E, but recommends that employers be excluded from some or all of the requirements of the regulation.

## **Check conversion services**

### **Merchants and other payees subject to Regulation E**

The Federal Reserve “believes that all parties engaged in electronic check conversion transactions should be subject to Regulation E for the limited purpose of obtaining authorizations” for these transactions. The Fed proposes to require merchants and other payees that initiate a one-time EFT using information from a consumer’s check to provide a notice in order to obtain a consumer’s authorization for the transfer. The notice must be provided for each transaction and must be clear and conspicuous.

NACHA—the association that establishes standards, rules and procedures for ACH transactions—also requires payees to give consumers notice about ECK transactions. NACHA rules provide that “notice=authorization” for accounts receivable conversion (ARC) transactions where checks are sent to a lockbox. NACHA currently requires a signed, written authorization from consumers for point-of-purchase (POP) check conversion.

This is the first time that Regulation E would require merchants and other payees to give notice of an ECK transaction. However, the Fed’s proposed rules provide model notification clauses “to protect merchants and other payees from liability...if the payee uses these clauses accurately to reflect its services.”

In view of this “safe harbor” provision, AFP agrees with the proposal to cover merchants and other payees under Regulation E for the purpose of obtaining authorizations.

### **Model clauses**

To give consumers additional information that would help them understand an ECK transaction, the Fed proposes that merchants and payees include in their required notices a statement to the effect that when or if the transaction is processed as an EFT,

- Funds may be debited from the consumer’s account quickly or as soon as the same day the check is received, and
- The consumer’s check will not be returned by the consumer’s financial institution [this statement is not required for a merchant who returns the check to a consumer in a POP transaction].

AFP recommends alternative wording that would reflect the changing payments processing environment and would not require costly, near-term revision.

### **Quick withdrawal of funds**

The increasing use, over the next several years, of substitute checks and check imaging will significantly reduce float and speed check clearing. Funds may be withdrawn from accounts quickly, regardless of whether the transaction is processed as an EFT or as a check. In fact, the Fed noted that “merchants or other payees may find it more efficient to process ‘local’ or ‘on-us’ items as checks rather than electronic check conversion transactions.”

AFP recommends that the phrase “when we use your check to make an electronic funds transfer” be deleted, and that the statement say simply “Funds may be withdrawn from your account quickly.”

#### Check return

We do not believe it is helpful to consumers to state that they will not receive a check used in an ECK transaction back from their financial institutions. Many consumers today do not receive any paid checks from their financial institutions, and that number is likely to grow. With Check 21, even consumers who receive paid checks may receive a mix of original checks and substitute checks. Consumers may be further confused by a statement from payees about the non-return of checks used in ECK transactions.

AFP recommends instead that the model clauses be changed to provide that the transaction will be reported on the bank (or financial institution) account statement, which would be true in all cases.

#### **Timing of Regulation E coverage**

AFP recommends an implementation date no earlier than 2006 (or twelve months from adoption of the final rule) for Regulation E coverage of merchants and other payees. Re-programming billing statements and revising and distributing point-of-sale signage have major budgetary and logistical consequences. Most 2005 budgets have already been approved and do not include funds for this project.

#### **Processing as an EFT or a check**

The Federal Reserve proposes to allow payees to obtain a consumer’s authorization to use information from a check to initiate an EFT or, alternatively, to process the item as a check. Currently, if a payee obtains a consumer’s authorization to initiate an EFT using information from a check, the consumer cannot also authorize the same document to be processed as a check.

AFP agrees with this proposed change to Regulation E. Merchants and other payees would be granted the flexibility to take advantage of the most efficient payments processing and clearing methods and to correct processing and other technical errors in a least-cost manner. For purposes of consumer authorization, the Fed has proposed model clauses that would allow merchants and other payees to provide one of two types of notices—stating that all checks will be converted, or stating that processing may occur as an EFT or a check.

#### Specification of circumstances

The Federal Reserve requested comment on whether merchants and other payees should be required to specify the circumstances under which a check that can be used to initiate an EFT will be processed as a check.

AFP recommends that specification of circumstances should not be required, but should be an option at the discretion of the payee. AFP supports the inclusion of model clauses permitting either option. Consumers are not knowledgeable about the details of check processing and are more likely to be confused rather than enlightened by the explanation. In addition, there are

many reasons why payees may choose to process a transaction as an EFT or a check, ranging from technical problems with the check itself to the location of the bank on which the check is drawn, to business continuity and disaster recovery needs.

#### Consumer harm

The Federal Reserve requested comment on whether affording payees the EFT or check processing option would cause consumer harm. Consumers would not know if their rights are governed by check law or Regulation E until they receive their account activity statement.

AFP does not believe that processing by either of these established payment methods will cause or increase potential consumer harm. As the Fed points out in its proposal, “under both check law and the EFTA, a consumer generally is not liable for unauthorized transactions, although the EFTA provides specific timeframes and procedures for asserting and resolving errors for EFTs.” Accordingly, because the consumer wrote a check that ordinarily would be covered by check law, the consumer will not be in a worse position in terms of legal liability if the merchant or payee elects to process it, after notice to the consumer, as an ECK transaction.

If an error appears on an account statement, consumers report the error to their financial institution, which should be responsible for educating consumers on their rights and following appropriate procedures, whatever the payment method.

#### **Signature at point of sale**

The Federal Reserve requested comment on whether merchants or other payees should be required to obtain the consumer’s written signed authorization to convert checks received at point of sale. NACHA rules currently require a signed, written authorization to convert checks in the POP application.

However, merchants would benefit by having the flexibility to process the payment as an EFT transaction or, alternatively, as a check, as noted by the Fed in its proposal. These decisions would generally be made at the back-office location of the merchant, its service provider or its financial institution, not at the point of sale.

AFP recommends that a signed, written authorization should not be required at point of sale when a clear and conspicuous notice (the model clause) is posted on a sign or a written statement is provided at point of sale. However, the Federal Reserve should make clear in its regulation or its Commentary that its authorization requirements are minimum requirements, and that payment network rules may provide additional authorization requirements for specific payment applications.

#### **Notice=Authorization for insufficient funds (NSF) fees**

The Federal Reserve proposes to allow merchants or other payees to electronically debit a fee for insufficient funds from the consumer’s account when the consumer goes forward with a transaction after receiving notice that the fee will be collected electronically.

Under NACHA rules, consumers must sign a separate authorization to allow the payee to collect the returned check fee by originating an ACH debit against the consumer's account.

AFP agrees with the proposed change to notice=authorization for NSF fees, which would provide payees with the same ability to recover fees for returned EFT transactions as they have for checks. Currently, initial disclosures provided under Regulation E must specify other fees that may be imposed and there is no requirement that this disclosure be signed by consumers. As in the above instance, the Federal Reserve should make clear that additional authorization requirements may be established by payment network rules.

### **Multiple checks for a single invoice**

Current check conversion rules are unclear about authorization to convert checks to ACH debits when multiple checks are submitted to pay a single invoice.

The Federal Reserve proposes that, for ARC transactions, a payee sending notice of check conversion to a consumer holding an account with the company may convert multiple checks submitted as payment for that account after the consumer receives the invoice or during a single billing cycle.

AFP agrees with this clarification, which would enable processing efficiency and eliminate uncertainty regarding payee responsibility to unknown parties.

### **Payroll Cards**

The Federal Reserve proposes that a "payroll card account," directly or indirectly established by an employer on behalf of a consumer to which EFTs of the consumer's wages, salary or other employee compensation is made on a recurring basis, should be an "account" covered by Regulation E. The account would be covered regardless of whether it is operated or managed by the employer, a third-party payroll processor, or a depository institution. Regulation E requires initial disclosures, periodic statements, error resolution procedures and other consumer protections.

AFP generally supports the proposal to cover payroll cards under Regulation E, since it might encourage acceptance of payroll cards among the unbanked. However, AFP has serious concerns about making employers "financial institutions" for purposes of Regulation E.

Regardless of how a payroll card program is established, it appears to be highly likely under the proposal that the employer would be at least one of two "financial institutions" involved. This poses significant compliance difficulties for employers. Employers typically do not have the systems to comply with periodic statement requirements, which would be extremely costly. Nor do employers typically have access to information that would enable them to respond to errors reported by the employee (e.g., report of an unauthorized withdrawal at an ATM). While the Fed noted that multiple financial institutions may agree among themselves to provide notices and handle other Regulation E duties, liability ultimately rests with all the financial institutions involved.

In order not to discourage employers from offering payroll card programs to employees, AFP recommends that the proposal be revised to exclude employers from some or all of the requirements of Regulation E, particularly the periodic statement and error resolution requirements. One option would be to provide that, to the extent that a depository financial institution or other third-party processor is deemed to be a “financial institution” for a payroll card program, the employer is not deemed also to be a “financial institution” for Regulation E purposes. Alternatively, AFP requests that the Fed consider modifications to the duties imposed on employers, as was provided for the Federal Government in the electronic benefits transfer program requirements under Section 205.15 of Regulation E.

If the Fed is unwilling to exempt employers from the requirements of Regulation E, employers will need at least 12-18 months to come into compliance with the revised regulation, either through negotiating appropriate agreements with the other financial institutions involved, or determining how and whether to comply with Regulation E or to terminate their payroll card program.

AFP thanks the Federal Reserve for the opportunity to comment on these proposed changes to Regulation E. Should you have questions about the Association’s position, please call Arlene Chapman of AFP at 301-907-2862.

Sincerely,



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