



March 10, 2006

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

Re: Docket No. R-1247  
Electronic Fund Transfers  
Interim final rule

Dear Ms. Johnson:

The Association for Financial Professionals (AFP) welcomes the opportunity to respond to the Federal Reserve Board's request for comment on the interim final rule that defines payroll card accounts as "accounts" for purposes of coverage under Regulation E. The Board states that it intends to include employers within the definition of financial institutions subject to Regulation E to the extent they are involved in the transfer of funds to the payroll card account or in the issuance of the card.

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 decisions regarding the use of electronic fund transfers (EFTs) for employee compensation, whether by direct deposit of payroll or the use of payroll cards. They thus have a sizable stake in the adoption of regulations that protect and promote the efficiency and integrity of their organizations' EFT payments to employees.

**Provisions of the Interim Rule**

Under the interim rule, a payroll card account is covered by Regulation E if it is "directly or indirectly established by an employer on behalf of a consumer to which electronic fund transfers of the consumer's wages, salary or other employee compensation are made on a recurring basis." A payroll account would be subject to the regulation whether the account "is operated or managed by the employer, a third-party payroll processor, a depository institution or any other person."

The Board specifically intends to make employers involved in payroll card programs “financial institutions” under Regulation E and subject to its requirements. The Board states that “a person is a financial institution subject to the regulation if it directly or indirectly holds a payroll card account or issues an access device to a consumer for use in initiating an EFT from a payroll card account.” 71 Fed. Reg. 1473, 1477 (Jan. 10, 2006).

For example, if an employer contracts with a financial institution and a third-party processor to issue an access device for a payroll card account, all three parties—the employer, the bank and the third-party processor—would be considered financial institutions with respect to that consumer’s payroll card account. The Board states, however, that the parties may contract among themselves as permitted by Regulation E § 205.4(e) to comply with Regulation E’s requirements so that the disclosure obligations satisfied by one party would satisfy disclosure obligations for any other “financial institution” for that account. Id.

### **AFP Position**

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 checks 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.

As stated in our comment letter of November 18, 2004, responding to the Fed’s earlier request for comment on the subject, AFP supports the objective of increased consumer protection for payroll cards and agrees with the proposal to cover payroll cards under Regulation E, since it might encourage increased acceptance of payroll cards. AFP supports the alternatives to periodic statements and related modifications set forth in § 205.18(b) and (c) of the interim rule.

However, AFP does not support the proposal to define employers as “financial institutions” for purposes of Regulation E coverage regardless of how the payroll card program is structured. There are valid precedents for excluding employers from Reg. E compliance for payroll card accounts as explained more fully below. AFP has serious concerns about introducing unwarranted complexity and creating legal barriers to the use of payroll cards, especially when these complex processes do not serve to increase consumer protection. As a consequence, employers might terminate payroll card programs or refrain from offering their employees what the Board’s cardholder focus groups have agreed are convenient payment vehicles.

### **Payroll Direct Deposit and Payroll Cards**

Payroll card programs vary in their operation, depending on the payroll card vendor. In one frequently used model, the payroll card program is similar to a payroll direct deposit program.

As part of a payroll direct deposit program, employers often arrange with a local financial institution to offer free checking accounts to employees who sign up for direct deposit. The employer may host representatives of the local financial institution at the job site as

part of a special event to raise awareness and make the process as easy as possible. Employees are under no obligation to open an account at that institution. However, many employees voluntarily do open accounts in their own names and authorize their employers to electronically deposit their wages or other compensation into those accounts. The employer's involvement thereafter is simply to arrange for an electronic funds transfer of wages to the account designated by the employee. The employer does not have the knowledge of the employee's available balances to answer questions or produce a statement. If an ATM card was issued to access the account, the employer does not have the knowledge or the means to deal with unauthorized use of the card.

In many payroll card programs, the employer arranges with a depository financial institution or other third-party vendor (collectively, "bank") to offer payroll cards to employees. Employees enroll in the payroll card program by signing an application form or agreement *with the bank, not with the employer*. Application forms may be submitted by employees directly to the bank or, depending on the model, employees may designate the employer as their agent solely for the purposes of submitting the application to the bank. Employees also sign the employer's direct deposit form, just as they would if their funds were electronically deposited through a payroll direct deposit program.

The bank issues and mails the payroll cards to employees, the accounts are in employees' names, and all questions related to the card—lost cards, forgotten PINs, card acceptance problems—are directed to the bank. In most instances, the bank retains responsibility for escheatment.

Many large depository financial institutions currently offer payroll cards using this model and they are fully compliant with Regulation E requirements, including disclosures, communication, error resolution, claims and account reporting. They do not pass along any Regulation E-related responsibilities to the cardholder's employer, nor does either party contemplate that the employer would ever be considered a joint "financial institution" given the existing definition of that term in § 205.2(i).

### **Consequences of Interim Final Rule**

AFP does not understand the reasons that the Board includes an employer within the definition of a financial institution for payroll card accounts simply because a payroll card is used to access wages or other compensation that the employer has deposited in an account in the employee's name. The value to be gained from such a change is not apparent. This is especially true for the type of existing payroll card program described. By covering the employer in all cases, there also seems to be an inherent assumption that the employer-employee relationship does not end. However, an employee may quit or be fired with a balance remaining in a payroll card account for which the employer would have continuing Regulation E responsibilities if not previously assumed by another party through contract.

Assigning responsibility to multiple parties in an EFT transaction adds complexity without adding safety and security. Financial institutions have for many years been responsible for complying with Regulation E and have the procedures and capabilities to carry out those responsibilities.

If this interim final rule is adopted, employers—even those with existing payroll card programs that are fully compliant with Regulation E—would be required to negotiate agreements with financial institutions issuing payroll cards to their employees to ensure that the institutions fulfill all the obligations of Regulation E, regardless of whether the institution is currently performing those tasks. The negotiation of these agreements is likely to be inherently weighted in favor of financial institutions, both because of the unequal bargaining power of small businesses compared with financial institutions, and because of companies’ lack of familiarity with the responsibilities of Regulation E compliance. Even if a financial institution assumes the duties contractually, obtaining a basic indemnification clause to protect the employer if the financial institution breaches its duties will be extremely difficult based on our members’ experiences in analogous situations.

AFP is also concerned that the language used in § 205.2(b)(2) of the interim rule may be broad enough to capture a payroll direct deposit program as described above, where the employer has some involvement in making available to its employees a free checking account program with a local financial institution and the employees sign the employer’s direct deposit authorization form.

### **Suggested Revisions**

To cover payroll card accounts under Regulation E does not require that all employers become “financial institutions” under Regulation E. What is important is that at least one person related to the payroll card program, whether it be the employer, a bank, or a third-party processor, agrees to provide electronic fund transfer services. Then, by operation of § 205.2(i), that person automatically becomes a “financial institution” subject to all requirements. To accomplish this goal, we recommend changes to both § 205.2(b)(2) and § 205.18(a) as added by the interim rule, as shown below:

#### *§ 205.2(b)(2)*

The term includes a “payroll card account” ~~directly or indirectly established by an employer on behalf of a consumer which is designed to be accessed by a~~ consumer primarily through an access device and to which electronic fund transfers of the consumer’s wages, salary, or other employee compensation are made on a recurring basis, whether the account is operated or managed by the employer, a third-party payroll processor, a depository institution, or any other person. For rules governing payroll card accounts, see § 205.18.

#### *§ 205.18(a)*

~~A person is a financial institution for purposes of the act and this part if it directly or indirectly holds a payroll card account as described in § 205.2(b)(2) or directly or indirectly issues an access device to a consumer for use in initiating an EFT from a payroll card account.~~ An access device for a payroll card account as described in § 205.2(b)(2) may be issued to a consumer only if a bank, savings association, credit union, or other person agrees with the consumer to provide electronic fund transfer services. ~~The person-financial institution shall comply~~

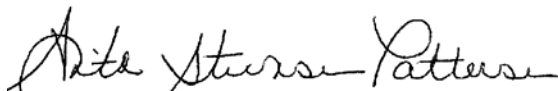
with all applicable requirements of the act and this part with respect to payroll card accounts except as provided in this section.

### Summary of AFP Recommendations

- AFP supports the objective of increased consumer protection for payroll cards and agrees with the proposal to cover payroll cards under Regulation E. AFP also supports the alternatives to periodic statements and related modifications set forth in the interim rule.
- AFP does not support the proposal to define employers as “financial institutions” for purposes of Regulation E coverage regardless of how the payroll card program is structured.
- AFP suggests that, in covering payroll accounts under Regulation E, what is important is that at least one person related to the payroll card program, whether it be the employer, a bank or a third-party processor, agrees to provide electronic fund transfer services. That person would then automatically become a “financial institution” subject to Regulation E requirements.
- AFP recommends changes to **§ 205.2(b)(2) Definitions** and **§ 205.18(a) Requirements for Financial Institutions Offering Payroll Card Accounts** of the interim final rule to achieve this objective. AFP believes that these changes would advance consumer protection while eliminating unnecessary complexity that might inhibit the availability to consumers of an efficient and convenient electronic payment vehicle.

AFP thanks the Federal Reserve for the opportunity to comment on the interim final rule for payroll card accounts. Should you have questions about the Association’s position, please call Arlene Chapman of AFP at 301-907-2862.

Sincerely,



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