

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## FEDERAL RESERVE SYSTEM

### 12 CFR Part 205

[Regulation E; Docket No. R-1210]

#### Electronic Fund Transfers

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed rule; official staff interpretation.

**SUMMARY:** The Board is publishing for comment a proposal to amend Regulation E, which implements the Electronic Fund Transfer Act. The proposal would also revise the official staff commentary to the regulation. The commentary interprets the requirements of Regulation E to facilitate compliance primarily by financial institutions that offer electronic fund transfer services to consumers.

Proposed revisions to the regulation would address its coverage of electronic check conversion services and those providing the services. Among other things, persons, such as merchants and other payees, that make electronic check conversion services available to consumers would have to obtain a consumer's authorization for the electronic fund transfer. In addition, the regulation would be revised to provide that payroll card accounts established directly or indirectly by an employer on behalf of a consumer for the purpose of providing salary, wages, or other employee compensation on a recurring basis are accounts covered by Regulation E. Proposed commentary revisions would provide guidance on preauthorized transfers, additional electronic check conversion issues, error resolution, and other matters.

**DATES:** Comments must be received on or before November 19, 2004.

**ADDRESSES:** Comments, which should refer to Docket No. R-1210, may be mailed to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. Because paper mail in the

Washington area and at the Board of Governors is subject to delay, please consider submitting your comments by e-mail to

*regs.comments@federalreserve.gov*, or faxing them to the Office of the Secretary at 202-452-3819 or 202-452-3102. Members of the public may inspect comments in room MP-500 in the Board's Martin Building between 9 a.m. and 5 p.m. on weekdays pursuant to section 261.12, except as provided in section 261.14, of the Board's Rules Regarding the Availability of Information, 12 CFR 261.12 and 261.14.

**FOR FURTHER INFORMATION CONTACT:** Ky Tran-Trong, Senior Attorney, or Daniel G. Loneragan, David A. Stein, Natalie E. Taylor or John C. Wood, Counsels, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452-2412 or (202) 452-3667. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263-4869.

#### 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 EFTA is implemented by the Board's Regulation E (12 CFR part 205). Examples of 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 (ACH), telephone bill-payment plan, or remote banking service. The act and regulation require disclosure of terms and conditions of an EFT service; documentation of electronic transfers by means of terminal receipts and periodic account activity statements; limitations on consumer liability for unauthorized transfers; procedures for error resolution; and certain rights related to preauthorized EFTs. Further, the act and regulation also prescribe restrictions on the unsolicited issuance of ATM cards and other access devices.

The Official Staff Commentary (12 CFR part 205 (Supp. I)) is designed to facilitate compliance and provide protection from liability under sections 915 and 916 of the EFTA for financial

institutions and persons subject to the Act. 15 U.S.C. 1593m(d)(1). The commentary is updated periodically, as necessary, to address significant questions that arise.

## II. Summary of Proposed Revisions

### *Electronic Check Conversion*

In an electronic check conversion (or "ECK") transaction, a consumer provides a check to a payee and information from the check is used to initiate a one-time EFT from the consumer's account. Specifically, the payee electronically scans and captures the MICR-encoding on the check for the routing, account, and serial numbers, and enters the amount to be debited from the consumer's asset account. The EFTA expressly provides that transactions originated by check, draft, or similar paper instrument are not governed by the Act. In response to an industry request that the Board clarify EFTA coverage of ECK transactions, the Board's March 2001 amendments to the Official Staff Commentary to Regulation E established a bright-line test for the regulation's coverage of these transactions. See 66 FR 15187 (March 16, 2001).

The staff commentary provides that electronic check conversion transactions are covered by the EFTA and Regulation E if the consumer authorizes the transaction as an EFT. This is the case regardless of whether the check conversion occurs at point-of-sale ("POS") or in an accounts receivable conversion ("ARC") transaction where the consumer mails a fully completed and signed check to the payee that is converted to an EFT. The commentary provides that a consumer authorizes an EFT if notice that the transaction will be processed as an EFT is provided to the consumer and the consumer completes the transaction.

Since issuing the March 2001 commentary update, several issues have arisen relating to electronic check conversion transactions in general, and ARC transactions in particular. Concerns have been raised about the uniformity and adequacy of some of the notices provided to consumers about ECK transactions. Some in the industry would like the flexibility to obtain a consumer's authorization to process a transaction as an EFT or as a check. Board staff also has received inquiries from financial institutions and other

industry participants concerning their obligations under Regulation E in connection with ECK services. For example, merchants and other payees have inquired whether a single authorization is sufficient to convert multiple checks submitted as payment after receiving an invoice or during an individual billing cycle, in the case of a credit card bill, for example. Banks and credit unions have asked about the extent of their disclosure obligations to both existing and new consumers about the addition of ECK services to the terms of consumer accounts.

Proposed revisions to the regulation would address its coverage of electronic check conversion services and those providing the services. The proposal would provide additional guidance regarding the rights, liabilities, and responsibilities of parties engaged in ECK transactions. First, the regulation would be revised to include the guidance on Regulation E coverage of ECK transactions currently contained in the commentary. Where a check, draft, or similar paper instrument is used as a source of information to initiate a one-time EFT from the consumer's account, that transaction is not deemed to be a transfer originated by check, and thus is covered by Regulation E. Second, pursuant to its authority under section 904(d) of the EFTA, the Board would require persons, such as merchants and other payees, that make ECK services available to consumers to obtain a consumer's authorization for the electronic transfer. (See §§ 205.3(a) and (b)(2); comment 3(b)(2)-1.) This requirement would enable the Board to promote consistency in the notice provided to consumers by merchants and other payees.

Generally, a notice about authorizing an ECK transaction would have to be provided for each transaction. The notice can be a generic statement posted on a sign or a written statement at POS, or provided on or with a billing statement or invoice, and must be clear and conspicuous. The regulation would also provide that obtaining authorization from a consumer holding the account on which a check will be converted is sufficient to convert multiple checks submitted as payment for a particular invoice or during an individual billing cycle.

To help consumers understand the nature of an ECK transaction, the regulation would require persons initiating an EFT using information from a consumer's check to provide notice to the consumer that when the transaction is processed as an EFT, funds may be debited from the consumer's account quickly. In

addition, as applicable, the person initiating the EFT would be required to notify the consumer that the consumer's check will not be returned by the consumer's financial institution.

Proposed model clauses would be provided to protect merchants and other payees from liability under Sections 915 and 916 of the EFTA, if the payee uses these clauses accurately to reflect its services. (See Appendix A, Model Clauses in A-6.)

A proposed revision to the commentary would explain that a payee may use the consumer's check as a source document for an ECK transaction or to process a check transaction, if the payee obtains the consumer's authorization. (See comment 3(b)(2)-2.) The commentary would also clarify that electronic check conversion transactions are a new type of transfer requiring new disclosures to the consumer to the extent applicable. (See comments 7(b)-4 and 7(c)-1.) Model clauses for initial disclosures would be revised to reflect that one-time EFTs may be made from a consumer's account using information from the consumer's check and to instruct consumers to notify their account-holding institutions when an unauthorized EFT has occurred using information from their check. (See Appendix A, Model Clauses in A-2.)

#### *Payroll Cards*

A majority of all employees in the United States have their pay deposited directly into an account at a financial institution. Some employees that still receive their pay by paper check may not have any account relationship with a financial institution. Payroll cards have become increasingly popular with some employers as a way to reduce payroll check processing costs and more economically pay employees who lack checking accounts. Typically, an employer (or a third party acting on behalf of the employer) will establish an account at a depository institution in which employees' salaries are periodically deposited and held on their behalf. Employees are issued a card that they can use to access their funds electronically to obtain cash at an ATM or make purchases at a POS location.

The regulation would be revised to provide 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 are made on a recurring basis, is an "account" covered by Regulation E. This account would be subject to the regulation whether the account is operated or managed by the employer, a third-party payroll processor, or a

depository institution. This does not include a card used for a one-time EFT of a salary-related payment, such as a bonus, or a card used solely to disburse non-salary-related payments, such as a petty cash or a travel per diem card. Of course, one-time payments and any other transfer of funds to or from a payroll card account established by an employer for the purpose of receiving EFTs of wages, salaries, or other employee compensation on a recurring basis would be covered by the act and regulation, even if the particular transfer itself does not represent wages, salary, or other employee compensation. (See § 205.2(b)(3); comment 2(b)-2.)

#### *Issuance of Access Devices*

In March 2003, the Board revised the official staff commentary to Regulation Z (Truth in Lending) to provide an exception to the "one-for-one" rule, which generally provides that a creditor may not issue more than one credit card as a renewal of, or substitute for, an accepted card. The revision allows creditors to replace an accepted credit card with more than one renewal or substitute card, subject to certain conditions. (See comment § 226.12(a)(2)-6 to Regulation Z.)

Under Regulation E, a proposed commentary revision would clarify that a financial institution may issue a supplemental access device in conjunction with the issuance of a renewal or substitute access device, subject to the conditions set forth in § 205.5(b) for unsolicited access devices, including the requirement that the device be unvalidated. (See comment 5(b)-5.) The general one-for-one rule in comment 5(a)(2)-1 would be retained, but with a cross-reference to proposed comment 5(b)-5.

#### *Error Resolution*

Section 205.11(c)(4) provides that a financial institution may satisfy its obligation to investigate an alleged error by reviewing its own records if the alleged error concerns a transfer to or from a third party and there is no agreement between the institution and the third party for the type of EFT involved. The proposal would provide additional guidance by revising the commentary to state that, under these circumstances, the financial institution would not satisfy its error resolution obligations by merely reviewing the payment instructions, for example, if there is additional information within the institution's own records that would assist in resolving the alleged error. (See comment 11(c)(4)-5.)

### *Preauthorized Transfers*

Section 205.10(b) requires that recurring electronic debits from a consumer's account be authorized "only by a writing signed or similarly authenticated by the consumer." The March 2001 commentary update clarified that the writing and signature requirements of this section could be satisfied by complying with the Electronic Signatures in Global and National Commerce Act (E-Sign Act), 15 U.S.C. 7001 *et seq.* (See comment 10(b)-5.)

The commentary provides that a tape recording of a telephone conversation with a consumer who agrees to preauthorized debits does not constitute written authorization under § 205.10(b). (See comment 10(b)-3.) That interpretation would be withdrawn to address industry concerns that the existing guidance may conflict with the E-Sign Act.

Consumers sometimes authorize third-party payees, by telephone or online, to submit recurring charges against a credit card account. If the consumer indicates use of a credit card account when in fact a debit card is being used, the payee does not violate the requirement to obtain a written authorization if the failure to obtain the authorization was not intentional and resulted from a bona fide error, and if the payee maintains procedures reasonably adapted to avoid any such error. The commentary would be revised to clarify that a merchant asking the consumer to specify whether a card to be used for the authorization is a debit card or is a credit card, using those terms, is a reasonable procedure. (See comment 10(b)-7.)

Section 205.10(c) requires a financial institution to honor a consumer's oral stop-payment order for a preauthorized transfer from his or her account if it is made at least three business days before a scheduled debit. The commentary would be revised to clarify that an institution that does not have the capability of blocking a preauthorized debit from being posted to the consumer's account (for example, when debits are made on a real-time system), may instead use a third party to block the transfer(s), as long as the recurring debits are in fact stopped. (See comments 10(c)-2 and -3.)

Section 205.10(d) requires a consumer's financial institution (or a designated payee) to send written notice to the consumer at least 10 days before the scheduled date of a preauthorized EFT from the consumer's account when the EFT will vary in amount from the previous transfer, or from the

preauthorized amount. The commentary would be revised to permit institutions to provide consumers with a range of varying amounts for transfers of funds, in lieu of providing notice with each varying transfer, when crediting preauthorized transfers of interest (for example, for a consumer's certificate of deposit account) to an account of the consumer held at a different financial institution. (See comment 10(d)(2)-2.)

### *Disclosures at Automated Teller Machines*

Section 205.16 provides that an ATM operator that imposes a fee on a consumer for initiating an EFT or balance inquiry must post notices at ATMs that a fee *will* be imposed. The commentary to § 205.16 would be revised to clarify that if there are circumstances in which an ATM fee will not be charged for a particular transaction, ATM operators may disclose on the ATM signage that a fee *may* be imposed. (See comment 16(b)(1)-1.)

## **III. Section-by-Section Analysis of the Proposed Revisions**

### *Section 205.2 Definitions*

#### 2(b) Account

Proposed § 205.2(b)(3) would provide that the term "account" includes 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 are made on a recurring basis. A payroll card account would be subject to the regulation whether the account is operated or managed by the employer, a third-party payroll processor, or a depository institution.

In 1994, the Board revised Regulation E to cover certain electronic benefit transfer programs ("EBT programs") established by the federal government in which welfare and similar government benefits were distributed to recipients electronically. These programs, which typically allow access to benefits through the use of debit cards at ATMs and POS locations, are subject to the requirements of the regulation, with some exceptions. In the preamble to the final rule, the Board stated that, notwithstanding the modified applicability of Regulation E to EBT programs, military and private sector employers who make salary and other payments available through systems permitting ATM access "remain fully covered by Regulation E." 59 FR 10678, 10680 (March 7, 1994).

In 1996, the Board issued a proposed rule that would have covered certain

stored-value products under Regulation E.<sup>1</sup> Congress imposed a moratorium on Board action and directed the Board to conduct a study on whether application of the provisions of the regulation would adversely affect the cost, development, and operation of stored-value products. The report concluded that full Regulation E coverage of stored-value products would likely impose substantial operating and opportunity costs of compliance. The Board noted that given the limited experience at that time it was difficult to predict whether the benefits to consumers from any particular provision of Regulation E would outweigh the corresponding costs of compliance.<sup>2</sup> The 1996 proposal was never finalized. In light of the increased usage of payroll cards today and the other reasons discussed more fully below, the regulation would be revised to cover these products under Regulation E.

Coverage of EFT services under the EFTA and Regulation E hinges upon whether a transaction involves an EFT to or from a consumer's account. Section 903(2) of the EFTA defines an "account" as "a demand deposit, savings deposit, or other asset account \* \* \* as described in regulations of the Board, established primarily for personal, family, or household purposes." The definition is broad and is not limited to traditional checking and savings accounts.<sup>3</sup> The Board possesses broad authority under section 904(d) of the EFTA to determine coverage when EFT services are offered by entities other than traditional financial institutions. Moreover, Congress has clearly enunciated its expectation that the Board continue to examine new and developing EFT services to assure that the EFTA's basic protections continue to apply.<sup>4</sup>

Payroll cards have become increasingly popular with some employers, financial institutions, and payroll services providers. A payroll card account holds a consumer's wages, salary, or other recurring compensation payments—assets that the consumer is able to access and spend with a device that provides the functionality of a debit

<sup>1</sup> 61 FR 19696 (May 2, 1996).

<sup>2</sup> Report to the Congress on the Application of the Electronic Fund Transfer Act to Electronic Stored-Value Products (March 1997).

<sup>3</sup> The EFTA's legislative history evidences a clear Congressional intent that the definition of "account" be broad, so as to ensure that "all persons who offer equivalent EFT services involving any type of asset account are subject to the same standards and consumers owning such accounts are assured of uniform protection." S. Rep. No. 915, 95th Cong., 2d Sess. 9 (1978).

<sup>4</sup> See *id.*; S. Rep. No. 1273, 95th Cong., 2d Sess. 9-10, 25-26 (1978).

card. Typically, an employer, in conjunction with a bank, will provide an employee a plastic card with a magnetic stripe that accesses an account assigned to the individual employee. The employer will then credit this account with value each payday instead of providing the employee with a paper check (or making a direct deposit of salary to the employee's checking account). The employee-consumer can use the card assigned to the account to access his or her funds at an ATM and make purchases at POS. Some payroll card products provide the consumer with the ability to get cash back at POS, and offer such features as convenience checks and electronic bill payment. In some cases, these products may be covered by deposit insurance. These products are also actively marketed to employers and service providers as particularly effective means of providing wages to the millions of individuals who lack a traditional banking relationship. Payroll card products are, in effect, designed, implemented, and marketed as substitutes for traditional checking accounts at a financial institution.

The broad combination of characteristics of payroll card accounts has led the Board to conclude that payroll card accounts are appropriately classified as accounts. Much like the EBT products that fall within Regulation E's coverage, payroll card products are assigned to an identifiable consumer, represent a stream of payments to a consumer (which may be a primary source of the consumer's income or assets), are replenished on a recurring basis and can be used in multiple locations for multiple purposes, and utilize the same kinds of access devices, electronic terminals, and networks as do other EFT services. Payroll card products may even offer a broader level of functionality with respect to possible types of transactions than do EBT products. In addition, the design and market of payroll card products has positioned them as substitutes for traditional checking accounts and as a potential mechanism for holding the primary financial assets for an increasing number of Americans who are "unbanked."

The Board believes that it is appropriate to apply the Regulation E provisions, such as initial disclosures, periodic statements, error resolution procedures, and other consumer protections, to consumers who receive their salaries through payroll card accounts, which in many cases will constitute the bulk of the consumer's income. The Board believes that the benefits to consumers in covering

payroll card accounts under Regulation E outweigh the incremental costs that would be imposed on the institutions that offer these accounts.

Under proposed § 205.2(b)(3), the regulation would apply to any EFT to or from payroll card accounts established directly or indirectly by an employer on behalf of an employee for the purpose of receiving transfers of the employee's wages, salary, or other compensation made on a recurring basis, whether the payroll card product is operated or managed by the employer, a third-party payroll processor, or a depository institution. The definition generally includes a payroll card account that represents the means by which the employer regularly pays the employee's salary or other form of compensation, and would include, for example, card accounts for seasonal workers or employees that are paid on a commission basis. Payroll card accounts would be covered by the regulation whether the funds are held in individual employee accounts or in a pooled account, with "subaccounts" maintained by a depository institution (or by a third party) that enable a determination of the amounts of money owed to particular employees. The proposed revision is not intended to address the definition of "account" for purposes of any other statute or regulation.

The Board is limiting the scope of this proposal to payroll card products only. For example, the characteristics of payroll card accounts described above would not apply to a prepaid "gift" card issued by a merchant that can be used to purchase items in the merchant's store. In addition, as explained in proposed comment 2(b)-2, the regulation would not cover a card to which only one-time transfers of salary-related payments are made (e.g., to pay a bonus), or a card exclusively used to disburse non-salary-related payments, such as a petty cash or travel per diem card. A one-time bonus payment, a payment to reimburse travel expenses, or any other transfer of funds (e.g., if a consumer is permitted to add his or her own funds), however, would be covered to the extent that the funds are transferred to or from the employee's payroll card account. Current comment 2(b)-2 would be redesignated as comment 2(b)-3.

Regulation E defines the term "financial institution" to include any person that directly or indirectly holds an account belonging to a consumer or that issues an access device to a consumer and agrees with a consumer to provide EFT services. One or more parties involved in offering payroll card

accounts may meet the definition of a "financial institution" under the regulation—whether it be the employer, a financial institution, or other third party involved in the transfer of funds to the account or in the issuance of the card. For example, if an employer, by agreement, issues a payroll card to a consumer and opens an account at a bank into which the employer deposits the consumer's wages and from which the consumer can access funds by using the card, then both the employer and the bank would qualify as a financial institution with respect to that consumer's payroll card account. Existing regulatory language under § 205.4(e) addresses the regulatory framework for financial institutions that provide EFT services jointly. The parties may contract among themselves to comply with the regulation. For purposes of the access device issuance rule in § 205.5, a payroll card would be considered a solicited access device so long as a consumer must elect to have his or her salary credited to a payroll card account.

A review of several current payroll card products, their disclosures, and their promotional materials indicates that, while some issuers are already generally compliant with the regulation's requirements, others are providing only partial Regulation E disclosures, or an incomplete level of protection with respect to error resolution, liability for loss, and other provisions. Some product providers may believe that certain payroll cards are not covered by the regulation due to the characteristics of their particular payroll card program, or because a "traditional" bank account may not be established by a consumer. If the proposal is finalized, financial institutions will be given time to make the necessary changes for compliance with the regulation. To the extent disclosures are needed to bring existing accounts into compliance, disclosures would have to be provided to employee-consumers, such as error-resolution notices. Comment is solicited on whether six months following adoption of final rules is sufficient to enable financial institutions to implement the necessary changes to comply with the regulation.

In many cases, payroll card products may also carry deposit insurance. The Federal Deposit Insurance Commission currently is considering the circumstances under which funds underlying stored-value cards would be considered "deposits". Comment is solicited on whether Regulation E coverage should be determined by whether a payroll card account holds

consumer funds that qualify as eligible “deposits” for purposes of section 3(l) of the Federal Deposit Insurance Act.<sup>5</sup>

### Section 205.3 Coverage

#### 3(a) General

Section 205.3(a) would be revised to provide that proposed § 205.3(b)(2), discussed below, applies to persons.

#### 3(b) Electronic Fund Transfer

New comment 3(b)–3 would replace current comment 3(b)–3 to clarify that an electronic debit from a consumer’s account to collect a fee for insufficient funds when an EFT or a check is returned unpaid is covered by Regulation E, and must be authorized by the consumer. (The re-designation of current comment 3(b)–3 to proposed comment 3(b)(2)–1 is discussed below.)

#### Electronic Check Conversion

In electronic check conversion transactions, a consumer provides a check to enable a merchant or other payee to capture the routing, account, and serial numbers to initiate a one-time EFT from the consumer’s account. The EFTA excludes from coverage any transaction “originated by check, draft, or similar paper instrument.” 15 U.S.C. 1693a. In response to an industry request, the Board updated the commentary in March 2001 (66 FR 15187) to clarify, among other things, that electronic check conversion transactions are covered by Regulation E. This is the case whether the consumer’s check is blank, partially completed, or fully completed and signed; whether the check is presented to a merchant at POS or is mailed to a payee or lockbox and later converted to an EFT; or whether the check is retained by the consumer, the merchant or other payee, or the payee’s financial institution. (See comment 3(b)–1(v).)

Coverage of these transactions is predicated on the use of the consumer’s check as a source of information by a merchant or other payee to initiate a one-time EFT from the consumer’s account using information from the check. The consumer must authorize the transfer. The commentary provides that in electronic check conversion transactions, a consumer authorizes a one-time EFT when the consumer receives notice that the transaction will be processed as an EFT, and goes forward with the transaction by providing a check to a merchant or other payee for the MICR encoding. (This guidance is in comment 3(b)–3, which would be revised and re-designated as

comment 3(b)(2)–1.) As further stated in the supplemental information to the March 2001 update, a transaction in which a check is used as a source document to initiate an EFT is deemed *not* to be originated by check.

Proposed revisions to the regulation would address its coverage of electronic check conversion services and those providing the services. The proposed rule would provide additional guidance regarding the rights, liabilities, and responsibilities of parties engaged in ECK transactions. Section 205.3(b)(2) would be added to include the guidance on Regulation E coverage of ECK transactions currently contained in the commentary, with some revisions. Where a check, draft, or similar paper instrument is used as a source of information to initiate a one-time EFT from the consumer’s account, that transaction is covered by Regulation E, and is deemed not to be a transfer originated by check. (See § 205.3(b)(2)(i) and comment 3(b)(2)–1.)

Currently, a merchant or other payee that engages in electronic check conversion transactions is not covered by Regulation E, because it does not meet the definition of “financial institution,” if the merchant or other payee does not directly or indirectly hold a consumer’s account, or issue an access device and agree to provide EFT services. The Board acknowledged in the preamble to the March 2001 commentary update that a merchant or other payee is in the best position to provide notice to a consumer for the purpose of obtaining authorization of an ECK transaction, but the Board deemed it unnecessary to bring these persons within the coverage of the regulation, stating its belief and expectation that merchants or other payees would provide consumers with the necessary notice.<sup>6</sup> The Board cautioned, however, that if it found that consumers were not receiving proper notice in connection with ECK transactions, it would consider exercising its authority under section 904(d) of the EFTA to require compliance by merchants and other payees.<sup>7</sup>

<sup>6</sup> At that time, and currently, NACHA, the national association that establishes the standards, rules, and procedures for the ACH system, requires merchants to obtain a written signed or similarly authenticated authorization from the consumer for ECK transactions from a consumer’s account. The authorization must be readily identifiable as an authorization and must clearly and conspicuously state its terms. NACHA’s signed authorization requirement does not apply to checks mailed to a payee or placed in a payee’s dropbox.

<sup>7</sup> Section 904(d)(1) of the EFTA provides that [i]f electronic fund transfer services are made available to consumers by a person other than a financial institution holding a consumer’s account, the Board

Since issuing the 2001 commentary revisions, concerns have been raised about the uniformity and adequacy of some of the notices to consumers about electronic check conversion transactions. Some notices are difficult to comprehend. The terminology used to describe electronic check conversion is not uniform. And some notices are not readily noticeable to consumers.

To assure consistency and clarity of disclosures, the Board believes that all parties engaged in electronic check conversion transactions should be subject to Regulation E for the limited purpose of obtaining authorizations for electronic check conversion transactions. Accordingly, the Board proposes to exercise its authority under section 904(d) of the EFTA to require persons, such as merchants and other payees, that initiate a one-time EFT using information from the consumer’s check, draft or similar paper instrument, to provide notice to obtain a consumer’s authorization for the transfer. Section 205.3(a) would be revised and § 205.3(b)(2)(ii) would be added to reflect this requirement. Persons subject to the proposed requirement in § 205.3(b)(2)(ii) would include financial institutions to the extent that they initiate an EFT using information from a consumer’s check.

Generally, a notice about authorizing an ECK transaction would have to be provided for each transaction. The notice can be a generic statement posted on a sign or a written statement at POS, or provided on or with a billing statement or invoice, and must be clear and conspicuous. At POS, a written signed authorization may be viewed as a more effective means than signage for informing consumers that their checks are being converted. Comment is solicited on whether merchants or other payees should be required to obtain the consumer’s written signed authorization to convert checks received at POS.

For ARC transactions, obtaining a single authorization from a consumer holding an account is sufficient to convert multiple checks submitted as payment after receiving an invoice or during a single billing cycle. (See § 205.3(b)(2)(ii).) For example, if several roommates each write a check in payment of a shared utility bill, authorization from the person whose name is on the utility account constitutes authorization to convert all the checks submitted in payment of that bill.

shall by regulation assure that the disclosures, protections, responsibilities, and remedies created by [the EFTA] are made applicable to such persons and services.

<sup>5</sup> See Definition of “Deposit”; Stored Value Cards, 69 FR 20558 (April 16, 2004).

Consistent with the EFTA's purpose to enable consumers to understand their rights, liabilities and responsibilities in EFT systems, and given the unique characteristics of ECK transactions, the Board believes it is appropriate to provide consumers with additional information to help them understand the nature of an ECK transaction. Section 205.3(b)(2)(iii), as proposed, would require persons initiating an EFT using information from a consumer's check to provide notice that when the transaction is processed as an EFT, funds may be debited from the consumer's account quickly. In addition, the person initiating the EFT would also be required to notify the consumer that the consumer's check will not be returned by the consumer's financial institution, except that this additional notice need not be provided by a merchant that returns the consumer's check at POS. (*See also* comment 3(b)(2)–3, discussed below.)

Proposed model clauses would be provided to protect merchants and other payees from liability under Sections 915 and 916 of the EFTA, if the payee uses these clauses accurately to reflect its services. (*See* Appendix A, Model Clauses in A–6.)

Current comment 3(b)–3 states that in electronic check conversion transactions, a consumer authorizes a one-time EFT when the consumer receives notice that the transaction will be processed as an EFT, and goes forward with the transaction. This comment would be re-designated as comment 3(b)(2)–1, and a technical revision would be made. The phrase “completes the transaction” would be replaced with “goes forward with the transaction” to clarify that it is not necessary for a transaction to clear or settle, for example, in order for authorization to occur.

Proposed comment 3(b)(2)–2 would provide that a payee may obtain the consumer's authorization to use information from his or her check to initiate an EFT or, alternatively, to process a check. A proposed model clause in Appendix A–6 provides a sample authorization. Currently, if a payee obtains a consumer's authorization to initiate an EFT using the information from a check, the consumer cannot also authorize the same document to be processed as a check. Coverage of ECK transactions would continue to be predicated on the consumer's authorization to allow the merchant or other payee to process a check as a source document to initiate an ECK transaction. But the interpretation would be revised to facilitate payments and to give payees

the most flexibility in determining how best to process payments.

In some cases, due to processing or other technical errors, the MICR-encoding from the consumer's check cannot be verified by the consumer's financial institution and, thus, the EFT cannot be made. The payee would be able to use the original check or create a “substitute check,” discussed below, from the original check to process a payment. In other cases, some merchants or other payees may find it more efficient to process “local” or “on-us” items as check—rather than electronic check conversion—transactions. In addition, some have asked the Board to permit, with the consumer's authorization, checks that may be used as source documents for ECK transactions to be used to create substitute checks as defined under Regulation CC, which implements the Check Clearing for the 21st Century Act (Check 21).<sup>8</sup> These entities would like the flexibility to test various payment mechanisms to determine what form of electronic payment processing will be most efficient and cost effective.

If it chooses, a payee may specify the circumstances under which a check may not be used to initiate an EFT. A model clause is contained in proposed Appendix A–6 for that purpose. A payee might list the circumstances on or with a billing statement or invoice, or may provide the information through a toll-free telephone number. A payee could also provide the information through a website.

Electronic check conversion transactions present a unique type of EFT that does not neatly fit within the existing scheme for EFTs covered by Regulation E, in that a consumer's check is being used to initiate an EFT. A consumer may write and mail a fully completed check for payment, in the case of an ARC transaction, or provide a check at POS, and through the consumer's authorization, the transaction will be processed as an EFT.

Generally, coverage of a transaction under the EFTA and Regulation E is determined by how a transaction is originated, not how it is carried out. And generally, consumers specifically instruct financial institutions or persons to debit or credit their accounts through EFTs. By allowing payees to obtain a consumer's authorization to use information from a check to initiate an EFT or, alternatively, to process a transaction as a check, the consumer does not know whether his or her rights will be governed by check law or

Regulation E until the consumer receives a periodic account activity statement identifying the transaction as a check transaction or as an EFT.<sup>9</sup> Therefore, comment is solicited on whether a disclosure stating that a consumer authorizes an EFT, or in the alternative, a check transaction, may result in any consumer harm or create any other risks. In particular, comment is solicited on whether payees that obtain alternative authorization 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.

Consumer education about ECK transactions and other electronic payments is critical as some consumers have been confused about how these transactions work and what happens to their check when it is converted to an EFT. The Board has published in English and Spanish a pamphlet about ECK transactions titled “When Is Your Check Not A Check? Electronic Check Conversion,” that it plans to update in the near future.

Proposed comment 3(b)(2)–3 would provide the guidance above that a payee initiating an EFT at POS would not be required to notify a consumer that the consumer's check will not be returned by the consumer's financial institution, if the payee returns the consumer's check to the consumer.

Proposed comment 3(b)(2)–4 would provide further guidance about authorization of an ECK transaction when multiple checks are offered as payment on a bill. A single authorization by a consumer holding an account is sufficient to convert multiple checks submitted as payment after receiving an invoice or during a single billing cycle, for example, in the case of a credit card account. Where an accountholder receives notice of check conversion and mails multiple checks to make a payment owed during a single billing cycle, it is reasonable to apply the ECK authorization notice to all checks provided—regardless of whether the checks are mailed within the same envelope or mailed separately during the billing cycle. Also, where an accountholder receives notice of check conversion and someone other than the accountholder, or in addition to the accountholder, provides a check to make a payment owed during the billing cycle, notice of check conversion to the accountholder is imputed as notice to those persons.

<sup>9</sup> 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.

<sup>8</sup> 12 U.S.C. 5001–5018, enacted on October 28, 2003, takes effect on October 28, 2004.

As noted above, model clauses are provided in proposed Appendix A-6 to protect merchants and other payees from liability under Sections 915 and 916 of the EFTA if such clauses are used properly to accurately reflect the merchant or other payee's practices. A merchant or other payee should construct a notice that best describes its individual practices. For example, for ARC transactions, a payee that opts to convert checks only in certain instances would generally provide notice that the customer authorizes the payee to use the check either to process an EFT or to process a check. In contrast, if a payee opts to convert all checks received by mail, the payee would provide notice to its customers stating that when the customer provides a check as payment, the customer authorizes the check to be used to make an EFT from the customer's account. Whether the payee in an ARC transaction intends to convert checks received in certain instances, or in all instances, the payee would be required to notify its customer that where the customer's check is converted, funds may be debited from the customer's account quickly, and that the customer will not receive his or her check back from the customer's financial institution. Similarly, to the extent that the payee intends to collect a fee for insufficient funds electronically, that fact must also be included on the notice.

Where a merchant or other payee initiates an EFT in error, the transaction would not be covered by Regulation E where the transaction does not meet the definition of an EFT. For example, if a merchant or other payee uses information from a consumer's money order mailed in by a consumer or from a convenience check tied to a line of credit to initiate an EFT, the transaction is not covered by Regulation E because there is no transfer of funds from a consumer account. Rather, the funds are transferred from an account held by the issuer of the money order or are extensions of credit. The transaction would be considered to have originated by check, even where notice has been provided that the transaction will be processed as an EFT.

### 3(c) Exclusions From Coverage

Comment 3(c)(1)-1 would be revised to clarify that a consumer authorizes a merchant or other payee to electronically debit a fee for insufficient funds from the consumer's account when the consumer goes forward with the transaction after receiving notice that the fee will be collected electronically.

### Section 205.5 Issuance of Access Devices

Section 911 of the EFTA, which is implemented by § 205.5 of Regulation E, generally prohibits financial institutions from issuing debit cards or other access devices except (1) in response to requests or applications or (2) as renewals or substitutes for previously accepted access devices. Existing comment 5(a)(2)-1 provides that, in general, a financial institution may not issue more than one access device as a renewal of or substitute for an accepted device (the "one-for-one rule"). These provisions were modeled on provisions in the Truth in Lending Act (TILA), Regulation Z, and its commentary that imposed similar restrictions on issuance of credit cards. (See TILA section 132; Regulation Z § 226.12(a); comment 12(a)(2)-5.)

In March 2003, the Board revised the Regulation Z Staff Commentary to provide an exception from the one-for-one rule to allow creditors to replace an accepted credit card with more than one replacement card, subject to certain conditions. (See comment 226.12(a)(2)-6.) Some industry representatives asked the Board to revise the Regulation E Staff Commentary to allow a financial institution, in connection with the renewal of or substitution for a previously accepted access device, to issue a supplemental access device to a consumer without complying with § 205.5(b). Section 205.5(b) requires, among other things, that any access device issued on an unsolicited basis be unvalidated at the time of issuance. Proposed comment 5(b)-5 would clarify that financial institutions may issue more than one access device during the renewal or substitution of a previously accepted access device, provided they comply with the conditions set forth in § 205.5(b) for the additional unsolicited devices. The general one-for-one rule in comment 5(a)(2)-1, however, would be retained, but a cross-reference to proposed comment 5(b)-5 would be added.

Unlike credit cards, a consumer's own funds are at risk of loss or theft in the event of unauthorized use of a debit card or other access device. The potential for unauthorized use may increase if cards are intercepted in the mail, and consumers are unaware that they may be receiving multiple cards as replacements for an existing access device. The validation requirement of § 205.5(b) avoids or limits monetary losses from the theft of debit cards sent through the mail. Although there would be no increase in a consumer's liability where multiple access devices are

issued, asserting a claim of unauthorized use can be inconvenient and time-consuming, and, at least temporarily, the consumer may be out of needed funds. Therefore, the consumer protection afforded by the one-for-one rule and the validation requirements of § 205.5(b) would appear to outweigh more flexibility in the one-for-one rule to parallel the credit card provisions.

### Section 205.7 Initial Disclosures

#### 7(a) Timing of Disclosures

Electronic check conversion transactions are a new type of transfer requiring new disclosures. (See discussion below under proposed § 205.7(c).) Comment 7(a)-1 would be revised to provide that an institution may choose to provide early disclosures about electronic check conversion transactions. (See also comment 7(a)-2, permitting an institution that has not received advance notice of a third party transfer to provide required disclosures as soon as reasonably possible after the first transfer.)

#### 7(b) Content of Disclosures

Proposed comment 7(b)(4)-4 would require financial institutions to list electronic check conversion transactions among the types of transfers that a consumer can make. (See Appendix A, Model Clauses in A-2.)

#### 7(c) Addition of Electronic Fund Transfer Services

Under the proposal, the general rule in comment 7(a)-4 would be moved to the regulation under new proposed § 205.7(c) for consistency with other regulations. Comment 7(a)-4 provides that if an EFT service is added to a consumer's account and is subject to terms and conditions different from those described in the initial disclosures, disclosures for the new service are required.

Following publication of the March 2001 commentary relating to ECK transactions, there was some industry uncertainty about the extent of an account-holding institution's disclosure obligations to new and existing consumers regarding ECK transactions. New comment 7(c)-1 would provide that ECK transactions are a new type of transfer requiring new disclosures to the consumer to the extent applicable. In this specific case, new disclosures would be necessary because a consumer's check can be used differently than in the past, in that information from the check can be used to initiate EFTs. (See also comment 7(b)(4)-4.) If finalized, financial institutions would be given sufficient

time to amend their disclosures if necessary.

Model clauses for initial disclosures in Appendix A of the regulation would be revised (1) to reflect that one-time EFTs are a new type of transfer that may be made from a consumer's account using information from the consumer's check and (2) to instruct consumers to notify their account-holding institutions when an unauthorized EFT has occurred using information from their check. (See Appendix A, Model Clauses in A-2.) Comment is solicited on whether six months is sufficient time following adoption of the final rule to enable financial institutions to revise their disclosures to comply with the rule.

#### *Section 205.10 Preauthorized Transfers*

##### 10(b) Written Authorization for Preauthorized Transfers From Consumer's Account

Under § 205.10(b), preauthorized EFTs from a consumer's account may be authorized only by a writing signed or similarly authenticated by the consumer. Currently, under comment 10(b)-3, an institution does not obtain written authorization for purposes of this provision by tape recording a telephone conversation with a consumer who agrees to recurring debits. In light of the E-Sign Act, this interpretation would be withdrawn.

Comment 10(b)-3 was adopted before the enactment of the E-Sign Act, which provides that, in general, electronic records and electronic signatures satisfy any legal requirements for traditional written records and signatures. Some have suggested that, given the E-Sign Act's broad definitions of "electronic record" and "electronic signature," a tape recorded authorization, or certain types of tape recorded authorizations, for preauthorized debits might be deemed to satisfy the Regulation E signed or similarly authenticated written authorization requirements.

Because the Board's authority to interpret the E-Sign Act is extremely limited, comment 10(b)-3 as amended would not address how the E-Sign Act should be interpreted in this regard. If, under the E-Sign Act, a tape recorded authorization, or certain types of tape recorded authorizations, were properly determined by the person obtaining the authorization to constitute a written and signed (or similarly authenticated) authorization, then the authorization would satisfy the Regulation E requirements.

Institutions should be aware, however, that to satisfy the

requirements of § 205.10(b) of Regulation E, an authorization, whether in paper or electronic form, must meet certain requirements. For example, the authorization must be readily identifiable as such to the consumer, and the terms of the preauthorized debits to be authorized must be clear and readily understandable to the consumer. (See comment 10(b)-6.)

Comment 10(b)-7 discusses authorizations for recurring payments obtained by telephone or on-line, and states that the payee's failure to obtain written authorization is not a violation if the failure was not intentional and resulted from a bona fide error, notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. For example, an error might occur where the consumer indicates that a credit card (for which no written authorization would be required) is being used for the authorization, when in fact the card is a debit card.

Given the recent growth of debit card usage, concerns have been expressed by retail and other industry groups about what would constitute procedures reasonably adapted to avoid error where a telemarketer seeks to obtain a consumer's authorization for recurring payments for goods or services (e.g., magazine subscriptions), using the consumer's credit or debit card. In the past, with relatively few debit cards in use compared to credit cards, it may have been reasonable for payees to use procedures not involving questions specifically referring to debit cards. Currently, however, between one-third and one-half of transactions where card numbers are used for payment authorizations may relate to debit cards. Therefore, reasonable procedures should include interaction with the consumer specifically designed to elicit information about whether a debit card is involved. Language would be added to comment 10(b)-7 to state that procedures reasonably adapted to avoid error will vary with the circumstances. The comment would also state that asking the consumer to specify whether the card to be used for the authorization is a debit card or is a credit card, using those terms, is a reasonable procedure.

Language would also be added to provide an example of a payee learning after the transaction occurred that the card used was a debit card: the consumer bringing the matter to the payee's attention. For example, the consumer may call the merchant to assert a complaint about use of a debit card without written authorization.

A related issue concerning reasonable procedures to avoid error under

comment 10(b)-7 has arisen following the settlement of litigation between a group of merchants and Visa and MasterCard, commonly referred to as the "Wal-Mart" settlement. See *In Re Visa Check/Mastermoney Antitrust Litigation*, No. CV-96-5238 (E.D.N.Y.). Under the terms of the settlement, Visa and MasterCard agreed to make available to merchants lists of credit and debit card Bank Identification Numbers referred to as "BIN tables." Because the BIN tables indicate whether a given card number relates to a credit card or to a debit card, questions have been raised about whether comment 10(b)-7 would require merchants to obtain and use the tables to verify that a card involved in a telephone authorization is a credit card or a debit card as a procedure "reasonably adapted" to avoid the error of accepting a debit card number.

To the extent that BIN tables are not available to merchants in an on-line, real-time form, it would likely be burdensome for merchants to be required to verify card numbers presented by consumers against the BIN tables. The verification could not occur during the telephone conversation between the merchant and the consumer, but instead would have to take place later; if the merchant then learned that the card used was a debit card rather than a credit card, the transaction would have to be unwound. Besides increasing merchant expense, unwinding the transaction might not be a result sought by the consumer, assuming the consumer had entered into the authorization with full knowledge of the terms and conditions. Accordingly, merchants are not required to obtain or consult BIN tables to maintain procedures reasonably adapted to avoid error. Similarly, merchants would not be required to check card numbers already on file against BIN tables. If in the future, however, the BIN tables become reasonably available to merchants in real-time, on-line form, this interpretation may need to be modified.

##### 10(c) Consumer's Right to Stop Payment

Proposed comment 10(c)-3 would be added to address procedures for stopping recurring debits in systems involving real-time processing, such as debit card systems. In real-time systems, the account-holding institution may not be able to block a payment from being posted to the consumer's account because the posting occurs almost immediately after the transaction has been approved, thus not allowing the institution sufficient time to identify payments against which stop-payment orders have been entered. The Board has



been asked how the account-holding institution can comply with the stop payment requirements of Regulation E in these circumstances. Proposed comment 10(c)–3 states that the institution need not have the capability to block recurring payments, and may instead use a third party to block the transfer(s), as long as such payments are in fact stopped. Comment 10(c)–2 would be revised to cross-reference the new proposed guidance.

#### 10(d) Notice of Transfers Varying in Amount

When a preauthorized EFT from a consumer's account will vary in amount from the previous transfer, or from the preauthorized amount, § 205.10(d) requires the designated payee or the consumer's financial institution to send written notice of the amount and date of the transfer at least 10 days before the scheduled date of the transfer. Paragraph 10(d)(2) permits the payee or the institution to give the consumer the option of receiving notice only when a transfer falls outside a specified range of amounts or only when a transfer differs from the most recent transfer by more than an agreed-upon amount.

Some financial institutions have suggested that while the notice requirement is appropriate where consumer funds are transferred to a third party, it should not apply when the transfer is between accounts owned by the same consumer, even when the accounts are held at different financial institutions. (Preauthorized transfers between accounts of the same consumer held at the *same* institution qualify for the intra-institutional exclusion from coverage in § 205.3(c)(5)). These institutions assert that the advance notice requirement is particularly burdensome for financial institutions that offer certificate of deposit (CD) products that allow customers to set up preauthorized transfers of interest from the CD account to another account of the consumer held at a different institution. For such products, monthly interest payments might vary solely because of the different number of days in each month, yet such variance would require the institution to send the consumer advance notice in each instance before transferring the funds.

Given the express language in section 907(b) of the EFTA, it is not appropriate to remove the notice requirement entirely. Nevertheless, to require that a notice be provided with each varying transfer where the transfer is between accounts owned by the same consumer provides little benefit to the consumer while imposing unnecessary costs on the financial institution making the

transfer. Thus, to provide additional flexibility, new proposed comment 10(d)(2)–2 would provide that a financial institution need not give the consumer the option of receiving notice before providing a consumer a range of varying amounts for transfers of funds to an account of the consumer held at another financial institution. The additional flexibility would also apply to transfers to or from a jointly-held account where the consumer is one of the joint account holders. Institutions must continue to provide consumers with the option to receive notice of all varying preauthorized debits to the consumer's account where the funds are transferred to something other than an account of the consumer held at another institution.

#### Section 205.11 Procedures for Resolving Errors

##### 11(b) Notice of Error From Consumer

Section 205.11 sets forth procedures for resolving errors, including the time limits within which an investigation must be concluded, a requirement to provisionally credit a consumer's account if the investigation cannot be completed within ten business days after the consumer's notice of error, and a reporting requirement to notify the consumer of the results of the investigation. The time limits and procedures required under § 205.11 are triggered by the consumer's notice of error when it is received in a timely manner, or "no later than 60 days after the institution sends the periodic statement or provides the passbook documentation \* \* \* on which the alleged error is first reflected." (See § 205.11(b).)

Inquiries have been made about the extent of the scope of a financial institution's investigation when a consumer provides a notice of error more than 60 days after the institution has sent the periodic statement that first reflected the alleged error. Proposed comment 11(b)–7 would provide that where the consumer fails to provide the institution with timely notice, the institution need not comply with the requirements of the section. Where the error involves an unauthorized EFT, however, liability for the unauthorized transfer may not be imposed on the consumer unless the institution satisfies the requirements in § 205.6.

##### 11(c) Time Limits and Extent of Investigation

###### Paragraph 11(c)(4)—Investigation

Section 205.11(c)(4) permits an institution to limit the investigation of an alleged error to "a review of its own

records" where the allegation pertains to a transfer to or from a third party with whom the institution has no agreement for the type of EFT involved. This is commonly referred to as the "four walls" rule. Comment 11(c)(4)–4 provides that a financial institution does not have an agreement solely because it participates in transactions that occur under the federal recurring payments programs or that are cleared through an ACH or similar arrangement for the clearing and settlement of fund transfers generally, or because it agrees to be bound by the rules of such an arrangement.

Proposed comment 11(c)(4)–5 would be added to provide that an institution's "own records" may include any information available within the institution that could be used to determine whether an error has occurred. Thus, for ACH, electronic check conversion, and other transactions, for example, a review of an institution's "own records" should not be confined to a review of the payment instructions when other information within the institution's "four walls" could also be reviewed.

The "four walls" rule was adopted when most third party transfers involved preauthorized credits to a consumer's account to pay salary or other compensation, or preauthorized debits from a consumer's account to pay a particular utility or other payee. In the absence of an agreement between the financial institution and the third party, it seemed reasonable to allow an institution to limit its investigation to the institution's own records. See 45 FR 8248 (February 6, 1980).

Historically, the alleged errors often pertained to the amount of the transfer; thus, an institution would likely have very limited information—such as the ACH payment instructions—for purposes of conducting its investigation. The "four walls" approach sought to strike an appropriate balance between an institution's statutory obligation to investigate errors and the institution's practical ability to resolve the alleged errors based on the limited information available to the institution.

The increasing use of ACH as a means to effectuate a wide variety of third party transfers (in addition to preauthorized transfers) expands the types of errors that consumers may assert beyond what was contemplated when the "four walls" rule was adopted over twenty years ago. For example, the ACH network can be used to process electronic check conversion transactions, whereby information from a consumer's blank, partially completed, or fully completed check is used to

initiate a one-time ACH debit from the consumer's account at POS or via a lockbox. Similarly, a merchant may use the ACH network in an on-line or telephone transaction to initiate an EFT from a consumer's account using the consumer's checking account number. In these cases, consumers can be expected to assert errors concerning authorizations and the type of transfers, in addition to errors regarding the amounts of the resulting ACH debits. The risk that a consumer's check(s) or checking account number could be used in a fraudulent manner to complete an ACH transfer from the consumer's account was not contemplated when the "four walls" analysis was adopted, since the typical ACH transfer then involved a preauthorized transfer to or from a known party.

Today, where a consumer believes that the transaction was unauthorized, for example, where the consumer's checks are stolen and used fraudulently to initiate EFTs from the consumer's account, information such as the location of the payee, the particular number of the check (to determine if it is notably out of order), or prior consumer account transactions with the same payee—all of which would be within the institution's own records—could be relevant to the investigation. In that case, a review of the ACH transfer instructions, without more, does not constitute a sufficient investigation under the rule.

Because the nature of a consumer's allegation of error can vary, the necessary inquiries to be made by an institution must vary. In each case, an institution should use any relevant information available within its own records for purposes of determining whether an error occurred. Proposed comment 11(c)(4)–5 provides this guidance.

The "four walls" rule may lead to somewhat arbitrary outcomes with respect to an institution's error resolution responsibilities for similar transactions solely as a result of the networks on which the transactions are processed. For instance, check conversion transactions may also be accomplished by means other than ACH, such as via a debit card network. In those circumstances, the account-holding institution is required to look beyond its own records to investigate asserted errors, as the network rules would likely constitute an agreement under § 205.11(c)(4). Similarly, in an on-line or telephone transaction, a consumer may choose to pay for a purchase by providing either his or her debit card number or his or her checking account number. If the

consumer later asserts an error in connection with the transaction, the scope of the account-holding institution's investigation will depend on the payment mechanism utilized by the consumer, despite the fact that in both cases, the consumer intended to pay for the transaction via an EFT debit to his or her bank account.

In light of new uses of the ACH to effectuate transfers to and from consumer accounts, in addition to soliciting specific comments on proposed comment 11(c)(4)–5, comment is solicited on whether there are circumstances in which the "four walls" rule should not apply.

#### *Section 205.16 Disclosures at Automated Teller Machines*

Section 205.16 requires an automated teller machine operator that imposes a fee on a consumer for initiating an electronic fund transfer or a balance inquiry to provide notice to the consumer that a fee will be imposed for providing the EFT service or balance inquiry and to disclose the amount of the fee. Notice of the imposition of the fee must be provided in a prominent and conspicuous location on or at the ATM. The operator must also provide notice that the fee will be charged and the amount of the fee either on the screen of the ATM or by providing it on paper, before the consumer is committed to paying a fee.

Several large institutions have asked whether it is permissible under the rule to provide notice on the ATM that a fee "may be" charged for providing EFT services, because many ATM operators, particularly those owned or operated by banks, may only apply ATM surcharges to some categories of their ATM users, but not others. For example, an ATM operator might not charge a fee to cardholders whose cards are issued by the operator, cardholders of foreign banks, and cardholders whose card issuer has entered into a special contractual relationship with the ATM operator with respect to surcharges. Also, an ATM operator might charge a fee for cash withdrawals, but not for balance inquiries. As a result, a disclosure on the ATM that a fee "will" be imposed in all instances could be overbroad and misleading with respect to consumers who would not be assessed a fee for usage of the ATM.

Under section 904(d)(3)(A) of the EFTA and § 205.16(b)(1), an ATM operator must provide notice that a fee will be imposed only if a fee is, in fact, imposed. A strict requirement to post a notice that a fee will be imposed in all instances could result in an inaccurate disclosure of the ATM operators'

surcharge practices. Accordingly, comment 205.16(b)(1)-1 would be revised to clarify that if there are circumstances in which an ATM surcharge will not be charged for a particular transaction, ATM operators may disclose on the ATM signage that a fee may be imposed or may specify the type of EFTs or consumers for which a fee is imposed. ATM operators that charge a fee in all instances would still be required to disclose that a fee will be charged for the transaction. Of course, before an ATM operator can impose an ATM fee on a consumer for initiating an electronic fund transfer or a balance inquiry, the ATM operator must provide to the consumer, notice either on-screen or via paper receipt, that an ATM fee will be imposed and the amount of the fee, and the consumer must elect to continue the transaction or inquiry after receiving such notice.

#### **Appendix A—Model Disclosure Clauses and Forms**

##### *A-2—Model Clauses for Initial Disclosures*

Model clauses for initial disclosures contained in Appendix A (Form A-2) would be revised to provide disclosures about electronic check conversion transactions. In particular, model clauses (a) and (b) would be revised to instruct consumers to notify their account-holding institution when unauthorized EFTs have been made without the consumer's permission using information from their checks. The discussion on the applicable liability limits remains generally unchanged, however, because the first two tiers of liability do not apply to unauthorized transfers made without an access device (for example, those made using information from a check to initiate a one-time ACH debit). (See comments 2(a)–2, 6(b)(3)–1.)

Model clause (d) also would be revised to list as a new type of transfer one-time electronic fund transfers made from a consumer account using information from the consumer's check. (See comment 7(b)(4)–4.)

##### *A-3—Model Forms for Error-Resolution Notice*

Paragraph (b) of Model Form A-3 would be restored after its inadvertent deletion following publication of the March 2001 interim final rule establishing uniform standards for the electronic delivery of disclosures required by the EFTA and Regulation E. 66 FR 17786 (April 4, 2001). No changes are intended by the reinsertion of paragraph (b). Paragraph (a) is reprinted for convenience.

*A-6—Model Clauses for Authorizing One-Time Electronic Fund Transfer Using Information From a Check (§ 205.3(b)(2))*

Proposed Model Form A-6 would be added to provide model clauses for the authorization requirements of proposed § 205.3(b)(2) for a person that initiates an EFT using information from a consumer's check. Consistent with comment 2 for Appendix A, the use of appropriate clauses in making disclosures will provide protection from liability under sections 915 and 916 of the EFTA provided the clauses accurately reflect the institution's EFT services. The Board request comment on whether it should retain all three of the proposed model clauses.

#### IV. Form of Comment Letters

Comment letters should refer to Docket No. R-1210 and, when possible, should use a standard typeface with a font size of 10 or 12; this will enable the Board to convert text submitted in paper form to machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Comments may be mailed electronically to [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov).

#### V. Solicitation of Comments Regarding the Use of "Plain Language"

Section 722 of the Gramm-Leach-Bliley Act of 1999 requires the Board to use "plain language" in all proposed and final rules published after January 1, 2000. The Board invites comments on whether the proposed rules are clearly stated and effectively organized, and how the Board might make the proposed text easier to understand.

#### VI. Initial Regulatory Flexibility Analysis

In accordance with section 3(a) of the Regulatory Flexibility Act, the Board has reviewed the proposed amendments to Regulation E. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

1. *Statement of the objectives of the proposal.* The Board is proposing revisions to Regulation E to require a person initiating an EFT using information from a consumer's check to obtain the consumer's authorization. This requirement would enable the Board to promote consistency in the notice provided to consumers by merchants and other payees.

The Board is also proposing in the regulation that payroll card accounts 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 are made on a recurring basis are "accounts" subject to Regulation E. Additional guidance would be provided in the staff commentary about a financial institution's error resolution obligations for certain transactions, and to clarify financial institution and merchant responsibilities for preauthorized transfers from consumer accounts.

The EFTA was enacted to provide a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer systems. The primary objective of the EFTA is the provision of individual consumer rights. 15 U.S.C. 1693. The EFTA and Regulation E require disclosure of terms and conditions of an EFT service; documentation of electronic transfers by means of terminal receipts and periodic statements; limitations on consumer liability for unauthorized transfers; procedures for error resolution; and certain rights related to preauthorized EFTs. The act and regulation also prescribe restrictions on the unsolicited issuance of ATM cards and other access devices. The EFTA authorizes the Board to prescribe regulations to carry out the purpose and provisions of the statute. 15 U.S.C. 1693b(a). The act expressly states that the Board's regulations may contain "such classifications, differentiations, or other provisions, \* \* \* as, in the judgment of the Board, are necessary or proper to carry out the purposes of [the act], to prevent circumvention or evasion [of the act], or to facilitate compliance [with the act]." 15 U.S.C. 1693b(c). The act also states that "[i]f electronic fund transfer services are made available to consumers by a person other than a financial institution holding a consumer's account, the Board shall by regulation assure that the disclosures, protections, responsibilities, and remedies created by [the act] are made applicable to such persons and services." 15 U.S.C. 1693b(d). The Board believes that the proposed revisions to Regulation E discussed above are within the Congress' broad grant of authority to the Board to adopt provisions that carry out the purposes of the statute.

2. *Small entities affected by the proposal.* The number of small entities affected by this proposal is unknown. Merchants or other payees that initiate one-time EFTs from a consumer's account using information from the consumer's check would be required under the regulation to obtain the consumer's authorization for the

transfers. Account-holding institutions would be required under the regulation to disclose to their consumers that electronic check conversion transactions are a new type of transfer that can be made from a consumer's account. In addition, employers, payroll services providers and depository institutions would be required to comply with the Board's Regulation E to the extent that they are engaged in providing payroll card products to employee-consumers.

The Board believes small merchants and other payees that engage in check conversion transactions are currently providing notices to obtain electronic check conversion transactions. These notices would have to be reviewed, and perhaps revised. In addition, small financial institutions may need to review their initial disclosures, and perhaps revise them to reflect that electronic check conversion transactions are a new type of transfer that can be made from a consumer's account. For payroll card products, the Board believes that small employers, payroll services providers, and depository institutions that provide such products are currently providing account-opening disclosures for those accounts, and may be providing some form of periodic disclosures. These disclosures will have to be reviewed to ensure that they are in compliance with Regulation E, and perhaps revised.

3. *Other Federal rules.* The Board believes no federal rules duplicate, overlap, or conflict with the proposed revisions to Regulation E.

4. *Significant alternatives to the proposed revisions.* The Board welcomes comment on any significant alternatives that would minimize the impact of the proposed rule on small entities.

#### VII. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The proposed rule contains requirements subject to the PRA. The collection of information that is required by this proposed rule is found in 12 CFR 205.2(b)(3), 205.3(b)(2) and 205.7. The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently valid OMB control number. The OMB control number is 7100-0200. This information is required to obtain a benefit for consumers and is mandatory (15 U.S.C. 1693 *et seq.*). The respondents/recordkeepers are for-profit

financial institutions, including small businesses. Institutions are required to retain records for 24 months.

All financial institutions subject to Regulation E, of which there are approximately 19,300, are considered respondents for the purposes of the PRA and may be required to provide notice to accountholders that electronic check conversion (ECK) transactions are a new type of transfer that may be made from a consumer's account under § 205.7. In addition, all persons, such as merchants and other payees, that engage in ECK transactions, of which there are approximately 11,900, potentially are affected by this collection of information, because these merchants and payees may be required to obtain a consumer's authorization for the electronic transfer under § 205.3(b)(2). Furthermore, all financial institutions involved in providing payroll card accounts to consumers (*i.e.*, employers, payroll card servicers, and depository institutions), of which there are approximately 2,000, potentially are affected by this collection of information because these institutions may be required to provide initial disclosures, periodic statements, error resolution procedures, and other consumer protections, to consumers who receive their salaries through payroll card accounts as defined in § 205.2(b)(3).

The following estimates represent an average across all respondents and reflect variations between institutions based on their size, complexity, and practices. The other federal agencies are responsible for estimating and reporting to OMB the total paperwork burden for the institutions for which they have administrative enforcement authority. They may, but are not required to, use the Federal Reserve's burden estimates.

The first disclosure requirement, described in § 205.7, is the initial disclosure that a financial institution would provide to their accountholders reflecting that ECK transactions are a new type of transfer that can be made from a consumer's account. The Federal Reserve estimates that each of the 1,289 institutions, for which the Federal Reserve has administrative enforcement authority (collectively referred to in the following paragraphs as "respondents regulated by the Federal Reserve") would be required to provide a revised initial disclosure to their accountholders. Currently, all respondents regulated by the Federal Reserve are required to provide a disclosure of basic terms, costs, and rights relating to EFT services under Regulation E. The Federal Reserve estimates that it will take financial

institutions, on average, 8 hours (1 business day) to reprogram and update systems to include the new notice requirement relating to ECK transactions; therefore, the Federal Reserve estimates that the total annual burden for respondents regulated by the Federal Reserve is 10,312 hours. The proposed revisions to Regulation E would provide institutions with model clauses for the initial disclosure requirement for ECK transactions (provided in Appendix A) that they may use to comply with the notice requirement. The total estimated annual burden for all other financial institutions subject to Regulation E providing initial disclosures would be approximately 144,088 hours, using the same burden methodology as above.

The second disclosure requirement, described in § 205.3(b)(2), is required when persons, such as merchants and other payees, engage in ECK transactions. Under the proposed rule, merchants and payees would be required to provide notice to obtain a consumer's authorization for the one-time EFT in the form of a written disclosure. The Federal Reserve estimates that of the 1,289 respondents regulated by the Federal Reserve that are required to comply with Regulation E, approximately 10 originate ECK transactions. The Federal Reserve estimates that it will take each respondent, on average, 8 hours (1 business day) to reprogram and update their systems to include the new notice requirement relating to ECK transactions; therefore, the Federal Reserve estimates that the total annual burden is 80 hours. The proposed revisions to Regulation E would provide institutions with model clauses (provided in Appendix A) for the new disclosure requirement. Using the Federal Reserve's methodology, the total annual burden for all other merchants and payees engaging in ECK transactions is 95,200 hours.

The third set of disclosure obligations is required when one or more parties that meet the definition of "financial institution" is involved in offering payroll card accounts as defined in § 205.2(b)(3)—whether the financial institution is an employer, a depository institution, or other third party involved in holding the payroll card account or in the issuance of a payroll card. Such entities would be required to fully comply with Regulation E, and provide disclosure of basic terms, costs, and rights relating to electronic fund transfer services in connection with the payroll card account. The parties may contract among themselves to comply with the regulation by providing one set of

disclosures. Certain information must be disclosed to consumers, including: initial and updated EFT terms, transaction information, periodic statements of activity, the consumer's potential liability for unauthorized transfers, and error resolution rights and procedures. The Federal Reserve estimates that of the 1,289 respondents regulated by the Federal Reserve that are required to comply with Regulation E, approximately 5 participate in payroll card programs. The Federal Reserve estimates that each respondent will take, on average, 1.5 minutes to prepare and distribute the initial disclosure to the payroll card account holders. The Federal Reserve also estimates that each respondent will take, on average, 7 hours to prepare and distribute periodic statements. Finally, the Federal Reserve estimates that each respondent will take, on average 30 minutes for error resolution procedures. The total annual burden for respondents regulated by the Federal Reserve for all of these disclosures is estimated to be 1,065 hours. Using the Federal Reserve's methodology, the total annual burden for all other institutions offering payroll card services would be approximately 20,500 hours. The disclosures are standardized and machine-generated and do not substantively change from one individual account to another; thus, the average time for providing the disclosure to all consumers should be small.

The Federal Reserve's current annual burden for Regulation E disclosures is estimated to be 48,868 hours. The proposed rule would increase the total burden under Regulation E for all respondents regulated by the Federal Reserve by 11,457 hours, from 48,868 to 60,325 hours. Using the methodology explained above, the proposed rule would increase total burden under Regulation E for all other potentially affected entities by approximately 259,788 hours.

Because the records would be maintained at state member banks and the notices are not provided to the Federal Reserve, no issue of confidentiality arises under the Freedom of Information Act.

Comments are invited on: a. whether the proposed 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 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 Cynthia Ayouch, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 41, Board of Governors of the Federal Reserve System, Washington, DC 20551, with copies of such comments sent to the Office of Management and Budget, Paperwork Reduction Project (7100-0200), Washington, DC 20503.

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed changes to the text of the regulation and staff commentary. New language is shown inside bold-faced arrows, while language that would be deleted is set off with bold-faced brackets. Comments are numbered to comply with Federal Register publication rules.

List of Subjects in 12 CFR Part 205

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

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR part 205 and the Official Staff Commentary, as follows:

PART 205—ELECTRONIC FUND TRANSFERS (REGULATION E)

1. The authority citation for part 205 would continue to read as follows:

Authority: 15 U.S.C. 1693b.

2. Section 205.2 would be amended by adding a new paragraph (b)(3) as follows:

§ 205.2 Definitions

\* \* \* \* \*

(b)(1) Account means \* \* \*

▶(3) The term includes a "payroll card account" 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, whether the account is operated or managed by the employer, a third-party payroll processor, or a depository institution. ◀

\* \* \* \* \*

3. Section 205.3 would be amended by revising paragraphs (a) and (b) as follows:

§ 205.3 Coverage

(a) General. This part applies to any electronic fund transfer that authorizes a financial institution to debit or credit

a consumer's account. Generally, this part applies to financial institutions. For purposes of §§ ▶205.3(b)(2), ◀ 205.10(b), (d), and (e) and 205.13, this part applies to any person.

(b) Electronic fund transfer. ▶(1)

Definition. ◀ The term electronic fund transfer that authorizes a financial institution to debit or credit a consumer's account. Generally, this part applies to financial institutions. The term includes, but is not limited to—

[(1)]▶(i)◀ point-of-sale transfers; [(2)]▶(ii)◀ automated teller machine transfers;

[(3)]▶(iii)◀ direct deposits or withdrawals of funds;

[(4)]▶(iv)◀ transfers initiated by telephone; and

[(5)]▶(v)◀ transfers resulting from debit card transactions, whether or not initiated through an electronic terminal.

▶(2) Electronic fund transfer using information from a check. (i) This part 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. The consumer must authorize the transfer.

(ii) The person that initiates a transfer shall provide notice to obtain a consumer's authorization for each transfer. Obtaining authorization from a consumer holding the account from which a check may be converted constitutes authorization for all checks provided for a single payment or invoice.

(iii) The person that initiates a transfer shall also provide notice to the consumer at the same time it provides the notice required under paragraph (b)(2)(ii) of this section that when a check is used to initiate an electronic fund transfer, funds may be debited from the consumer's account quickly, and, as applicable, that the consumer's check will not be returned by the financial institution holding the consumer's account. ◀

\* \* \* \* \*

4. Section 205.7 would be amended by adding a new paragraph (c) as follows:

§ 205.7 Initial disclosures

\* \* \* \* \*

▶(c) Addition of electronic fund transfer services. If an electronic fund transfer service is added to a consumer's account and is subject to terms and conditions different from those described in the initial disclosures, disclosures for the new service are required. ◀

5. In Appendix A to Part 205,

a. In A-2 MODEL CLAUSES FOR INITIAL DISCLOSURES (§ 205.7(b)),

paragraphs (a), (b) and (d) would be revised;

b. In A-3 MODEL FORMS FOR ERROR RESOLUTION NOTICE (§§ 205.7(b)(10) and 205.8(b)), paragraph (a) is republished, and paragraph (b) would be revised;

c. Appendix A-6 MODEL CLAUSES FOR AUTHORIZING ONE-TIME ELECTRONIC FUND TRANSFER USING INFORMATION FROM A CHECK (§ 205.3(b)(2)) would be added.

Appendix A to Part 205—Model Disclosure Clauses and Forms

\* \* \* \* \*

A-2—Model Clauses for Initial Disclosures (§ 205.7(b))

(a) Consumer Liability (§ 205.7(b)(1)). (Tell us AT ONCE if you believe your [card] [code] has been lost or stolen▶, or if you believe that an electronic fund transfer has been made without your permission using information from your check◀. Telephoning is the best way of keeping your possible losses down. You could lose all the money in your account (plus your maximum overdraft line of credit). If you tell us within 2 business days▶after you learn of the loss or theft of your [card] [code]◀, you can lose no more than \$50 if someone used your [card] [code] without your permission.) [(If you believe your [card] [code] has been lost or stolen, and you tell us within 2 business days after you learn of the loss or theft, you can lose no more than \$50 if someone used your [card] [code] without your permission.)]

If you do NOT tell us within 2 business days after you learn of the loss or theft of your [card] [code], and we can prove we could have stopped someone from using your [card] [code] without your permission if you had told us, you could lose as much as \$500.

Also, if your statement shows transfers that you did not make, ▶including those made by card, code or other means, ◀ tell us at once. If you do not tell us within 60 days after the statement was mailed to you, you may not get back any money you lost after the 60 days if we can prove that we could have stopped someone from taking the money if you had told us in time. If a good reason (such as a long trip or a hospital stay) kept you from telling us, we will extend the time periods.

(b) Contact in event of unauthorized transfer (§ 205.7(b)(2)). If you believe your [card] [code] has been lost or stolen[or that someone has transferred or may transfer money from your account without your permission], call:

[Telephone number]

or write:

[Name of person or office to be notified]  
[Address]

▶You should also call or write to the number or address listed above if you believe a transfer has been made using the information from your check without your permission. ◀

\* \* \* \* \*

(d) Transfer types and limitations (§ 205.7(b)(4))—(1) Account access. You may use your [card][code] to:

(i) Withdraw cash from your [checking] [or] [savings] account.

(ii) Make deposits to your [checking] [or] [savings] account.

(iii) Transfer funds between your checking and savings accounts whenever you request.

(iv) Pay for purchases at places that have agreed to accept the [card] [code].

(v) Pay bills directly [by telephone] from your [checking] [or] [savings] account in the amounts and on the days you request.

Some of these services may not be available at all terminals.

►(2) *Electronic check conversion.* You may authorize a merchant or other payee to make a one-time electronic payment from your checking account using information from your check to: (i) Pay for purchases; or (ii) Pay bills. ◀

[(2)] ►(3) ◀ *Limitations on frequency of transfers.*—(i) You may make only [insert number, e.g., 3] cash withdrawals from our terminals each [insert time period, e.g., week].

(ii) You can use your telephone bill-payment service to pay [insert number] bills each [insert time period] [telephone call].

(iii) You can use our point-of-sale transfer service for [insert number] transactions each [insert time period].

(iv) For security reasons, there are limits on the number of transfers you can make using our [terminals] [telephone bill-payment service] [point-of-sale transfer service].

[(3)] ►(4) ◀ *Limitations on dollar amounts of transfers.*—(i) You may withdraw up to [insert dollar amount] from our terminals each [insert time period] time you use the [card] [code].

(ii) You may buy up to [insert dollar amount] worth of goods or services each [insert time period] time you use the [card] [code] in our point-of-sale transfer service.

\* \* \* \* \*

### A-3 Model Forms for Error Resolution Notice (§§ 205.7(b)(10) and 205.8(b))

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

In Case of Errors or Questions About Your Electronic Transfers Telephone us at [insert telephone number] Write us at [insert address] [or E-mail us at [insert electronic mail address]] as soon as you can, if you think your statement or receipt is wrong or if you need more information about a transfer listed on the statement or receipt. We must hear from you no later than 60 days after we sent the FIRST statement on which the problem or error appeared.

(1) Tell us your name and account number (if any).

(2) Describe the error or the transfer you are unsure about, and explain as clearly as you can why you believe it is an error or why you need more information.

(3) Tell us the dollar amount of the suspected error.

If you tell us orally, we may require that you send us your complaint or question in writing within 10 business days.

We will determine whether an error occurred 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.

For errors involving new accounts, point-of-sale, or foreign-initiated transactions, we may take up to 90 days to investigate your complaint or question. For new accounts, we may take up to 20 business days to credit your account for the amount you think is in error.

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

►(b) *Error resolution notice on periodic statements (§ 205.8(b)).*

In Case of Errors or Questions About Your Electronic Transfers Telephone us at [insert telephone number] or Write us at [insert address] as soon as you can, if you think your statement or receipt is wrong or if you need more information about a transfer on the statement or receipt. We must hear from you no later than 60 days after we sent you the FIRST statement on which the error or problem appeared.

(1) Tell us your name and account number (if any).

(2) Describe the error or the transfer you are unsure about, and explain as clearly as you can why you believe it is an error or why you need more information.

(3) Tell us the dollar amount of the suspected error.

We will investigate your complaint and will correct any error promptly. If we take more than 10 business days to do this, we will credit your account 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. ◀

\* \* \* \* \*

### ►A-6—Model Clauses for Authorizing One-Time Electronic Fund Transfer Using Information From a Check (§ 205.3(b)(2))

(a)—*Sample Notice About Electronic Check Conversion*

When you provide a check, you authorize us either to use information from your check to make a one-time electronic fund transfer from your account or to process this transaction as a check. When we use your check to make an electronic fund transfer, funds may be withdrawn from your account [quickly/ as soon as the same day we receive your payment][, and you will not receive your check back from your financial institution.]

[If there are insufficient funds in your account, you authorize us to charge a fee of \$\*\*, and collect that amount through an electronic fund transfer from your account.]

(b)—*Optional Notice Where Checks Are Converted*

When you provide a check, you authorize us to use information from your check to

make a one-time electronic fund transfer from your account. When we use your check to make an electronic fund transfer, funds may be withdrawn from your account [quickly/ as soon as the same day we receive your payment] [, and you will not receive your check back from your financial institution.]

[If there are insufficient funds in your account, you authorize us to charge a fee of \$\*\*, and collect that amount through an electronic fund transfer from your account.]

(c)—*Optional Notice Where Checks Would Not Be Converted Under Specified Circumstances*

When you provide a check, you authorize us to use information from your check to make a one-time electronic fund transfer from your account. In certain circumstances, we may process your payment as a check. [Specify circumstances.] When we use your check to make an electronic fund transfer, funds may be withdrawn from your account [quickly/ as soon as the same day we receive your payment] [, and you will not receive your check back from your financial institution.]

[If there are insufficient funds in your account, you authorize us to charge a fee of \$\*\*, and collect that amount through an electronic fund transfer from your account.] ◀

6. In Supplement I to Part 205, the following amendments would be made:

a. Under *Section 205.2—Definitions*, under *2(b) Account*, paragraph 2. would be redesignated as paragraph 3. and a new paragraph 2. would be added;

b. Under *Section 205.3—Coverage*, under *3(b) Electronic Fund Transfer*, paragraph 3. would be revised;

c. Under *Section 205.3—Coverage*, under *3(b) Electronic Fund Transfer*, a new heading “Paragraph 3(b)(2)—Electronic Fund Transfer Using Information From a Check” would be added, and paragraphs 1. through 4. would be added;

d. Under *Section 205.3—Coverage*, under *3(c) Exclusions from coverage*, under heading Paragraph 3(c)(1)—Checks, paragraph 1. would be revised;

e. Under *Section 205.5—Issuance of Access Devices*, under *5(a) Solicited Issuance*, under Paragraph 5(a)(2), paragraph 1. would be revised;

f. Under *Section 205.5—Issuance of Access Devices*, under *5(b) Unsolicited Issuance*, paragraph 5. would be added;

g. Under *Section 205.7—Initial Disclosures*, under *7(a) Timing of Disclosures*, paragraph 1. would be revised, and paragraph 4. would be removed and reserved;

h. Under *Section 205.7—Initial Disclosures*, under *7(b) Content of Disclosures*, under Paragraph 7(b)(4)—Types of Transfers; Limitations, paragraph 4. would be added;

i. Under *Section 205.7—Initial Disclosures*, a new heading “7(c)

Addition of EFT Services'' would be added, and paragraph 1. would be added;

j. Under Section 205.10—Preauthorized Transfers, under 10(b) Written Authorization for Preauthorized Transfers from Consumer's Account, paragraphs 3. and 7. would be revised;

k. Under Section 205.10—Preauthorized Transfers, under 10(c) Consumer's Right to Stop Payment, paragraph 2. would be revised, and paragraph 3. would be added;

l. Under Section 205.10—Preauthorized Transfers, under 10(d) Notice of Transfers Varying in Amount, under Paragraph 10(d)(2)—Range, paragraph 2. would be added;

m. Under Section 205.11—Procedures for Resolving Errors, under 11(b) Notice of Error from Consumer, under Paragraph 11(b)(1)—Timing; Contents, paragraph 7. would be added;

n. Under Section 205.11—Procedures for Resolving Errors, under 11(c) Time Limits and Extent of Investigation, under Paragraph 11(c)(4)—Investigation, paragraph 5. would be added; and

o. Under Section 205.16—Disclosures at Automated Teller Machines, under 16(b) General, under Paragraph 16(b)(1), paragraph 1. would be revised.

Supplement I to Part 205—Official Staff Interpretations

\* \* \* \* \*

Section 205.2—Definitions

2(b) Consumer Asset Account

\* \* \* \* \*

►2. One-time EFT of salary-related payments. The term payroll card account does not include a card used for a one-time EFT of a salary-related payment, such as a bonus, or a card used solely to disburse non-salary-related payments, such as a petty cash or a travel per diem card. To the extent that one-time EFTs of salary-related payments and any other EFTs are transferred to or from a payroll card account, these transfers would be covered by the act and regulation, even if the particular transfer itself does not represent wages, salary, or other employee compensation.

[2.] ►3. \* \* \*

\* \* \* \* \*

Section 205.3—Coverage

\* \* \* \* \*

3(b) Electronic Fund Transfer

\* \* \* \* \*

[3. Authorization of one-time EFT initiated using MICR encoding on a check. A consumer authorizes a one-time EFT (in providing a check to a merchant or other payee for the MICR encoding), where the consumer receives notice that the transaction will be processed as an EFT and completes the transaction. Examples of notice include, but are not limited to, signage at POS and written statements.]

►3. NSF fees. If an EFT or a check is returned unpaid due to insufficient funds in a consumer's account, an EFT from the consumer's account to pay a NSF fee charged is covered by Regulation E and, therefore, must be authorized by the consumer.

►Paragraph 3(b)(2)—Electronic Fund Transfer Using Information From a Check.

1. Authorization of one-time EFT initiated using MICR encoding on a check. A consumer authorizes a one-time EFT (in providing a check to a merchant or other payee for the MICR encoding, that is, the routing number of the financial institution, the consumer's account number and the serial number), where the consumer receives notice that the transaction will be processed as an EFT and goes forward with the transaction. These transactions are not transfers originated by check. Examples of notice include, but are not limited to, signage at POS and individual written statements provided to consumers. (See model clauses in Appendix A-6.)

2. Authorization to process a transaction as an EFT or as a check. If a payee obtains a consumer's authorization to use a check solely as a source document to initiate an EFT, the payee cannot process the transaction as a check. In order to process the transaction as an EFT or alternatively as a check, the payee must obtain the consumer's clear authorization to do so. A payee may specify the circumstances under which a check may not be converted to an EFT. (See model clauses in Appendix A-6.)

3. When checks are returned at POS. A payee initiating an EFT that returns a consumer's check to the consumer at POS need not notify the consumer that the check will not be returned by the consumer's financial institution.

4. Multiple payments/multiple consumers. If a merchant or other payee will use information from a consumer's check to initiate an EFT from the consumer's account, notice to a consumer holding the account that a check provided as payment during a single billing cycle or after receiving an invoice will be processed as a one-time EFT constitutes notice for all checks provided for the billing cycle or invoice—whether from the consumer or someone else.

\* \* \* \* \*

3(c) Exclusions From Coverage

Paragraph 3(c)(1)—Checks

1. Re-presented checks. The electronic re-presentation of a returned check is not covered by Regulation E because the transaction originated by check. Regulation E does apply, however, to any fee authorized by the consumer to be debited electronically from the consumer's account because the check was returned for insufficient funds. Authorization occurs where the consumer has received notice that a fee imposed for returned checks will be debited electronically from the consumer's account[.] and goes forward with the transaction.

\* \* \* \* \*

Section 205.5—Issuance of Access Devices

\* \* \* \* \*

5(a) Solicited Issuance

\* \* \* \* \*

Paragraph 5(a)(2)

1. One-for-one rule. In issuing a renewal or substitute access device, [a financial institution may not provide additional devices.] ►only one renewal or substitute device may replace a previously issued device. ◀ For example, only one new card and PIN may replace a card and PIN previously issued. ►A financial institution, however, may provide additional devices at the time it issues the renewal or substitute access device, provided it complies with § 205.5(b). (See comment 5(b)-5.)

\* \* \* \* \*

5(b) Unsolicited Issuance

\* \* \* \* \*

►5. Additional access devices in a renewal or substitution. This regulation does not prohibit a financial institution from replacing an accepted access device with more than one access device during the renewal or substitution of a previously issued device, provided that any additional access device is not validated at the time it is issued, and the institution complies with the other requirements of § 205.5(b).

\* \* \* \* \*

Section 205.7—Initial Disclosures

7(a) Timing of Disclosures

1. Early disclosures. Disclosures given by a financial institution earlier than the regulation requires (for example, when the consumer opens a checking account) need not be repeated when the consumer later enters into an agreement with a third party to initiate preauthorized transfers to or from the consumer's account, unless the terms and conditions differ from those that the institution previously disclosed. ►The same applies with regard to disclosures about one-time EFTs from a consumer's account initiated using information from the consumer's check. ◀ On the other hand, if an agreement is directly between the consumer and the account-holding institution, disclosures must be given in close proximity to the event requiring disclosure, for example, when the consumer contracts for a new service.

\* \* \* \* \*

[4. Addition of EFT services. If an EFT service is added to a consumer's account and is subject to terms and conditions different from those described in the initial disclosures, disclosures for the new service are required. The disclosures must be provided when the consumer contracts for the new service or before the first EFT is made using the new service.]

\* \* \* \* \*

7(b) Content of Disclosures

\* \* \* \* \*

Paragraph 7(b)(4)—Types of Transfers; Limitations

\* \* \* \* \*

►4. One-time EFTs initiated using information from a check. Financial institutions are required to list one-time EFTs

initiated using information from a consumer's check among the types of transfers that a consumer can make. (See Appendix A-2.)

\* \* \* \* \*

7(c) Addition of Electronic Fund Transfer Services

►1. Addition of electronic check conversion services. One-time EFTs initiated using information from a consumer's check are a new type of transfer requiring new disclosures, as applicable. (See Appendix A-2.)

\* \* \* \* \*

Section 205.10—Preauthorized Transfers

\* \* \* \* \*

10(b) Written Authorization for Preauthorized Transfers From Consumer's Account

\* \* \* \* \*

3. Written authorization for preauthorized transfers. The requirement that preauthorized EFTs be authorized by the consumer "only by a writing" cannot be met by a payee's signing a written authorization on the consumer's behalf with only an oral authorization from the consumer. [A tape recording of a telephone conversation with a consumer who agrees to preauthorized debits also does not constitute written authorization for purposes of this provision.]

\* \* \* \* \*

7. Bona fide error. Consumers sometimes authorize third-party payees, by telephone or on-line, to submit recurring charges against a credit card account. If the consumer indicates use of a credit card account when in fact a debit card is being used, the payee does not violate the requirement to obtain a written authorization if the failure to obtain written authorization was not intentional and resulted from a bona fide error, and if the payee maintains procedures reasonably adapted to avoid any such error.

►Procedures reasonably adapted to avoid error will depend upon the circumstances. Generally, requesting the consumer to specify whether the card to be used for the authorization is a debit card or is a credit card, using those terms, is a reasonable procedure. Where the consumer has indicated that the card is a credit card (or that the card is not a debit card), however, the payee may rely on the consumer's assertion without seeking further information about the type of card. ◀ If the payee is unable to determine, at the time of the authorization, whether a credit or debit card number is involved, and later finds that the card used is a debit card ► (for example, because the consumer brings the matter to the payee's attention) ◀, the payee must obtain a written and signed or (where appropriate) a similarly authenticated authorization as soon as reasonably possible, or cease debiting the consumer's account.

10(c) Consumer's Right To Stop Payment

\* \* \* \* \*

2. Revocation of authorization. Once a financial institution has been notified that the consumer's authorization is no longer valid, it must block all future payments for

the particular debit transmitted by the designated payee-originator. ► (However, refer to comment 10(c)-3.) ◀ The institution may not wait for the payee-originator to terminate the automatic debits. The institution may confirm that the consumer has informed the payee-originator of the revocation (for example, by requiring a copy of the consumer's revocation as written confirmation to be provided within 14 days of an oral notification). If the institution does not receive the required written confirmation within the 14-day period, it may honor subsequent debits to the account.

►3. Alternative procedure for real-time processing. If an institution does not have the capability to block a preauthorized debit from being posted to the consumer's account as in the case of a preauthorized debit made through a debit card network or other real-time system, for example "the institution may instead comply with the stop-payment requirements by using a third party to block the transfer(s), as long as the recurring debits are in fact stopped. If in a particular instance, however, the debit is not stopped, the consumer's institution would not be in compliance with Regulation E in that instance. ◀

10(d) Notice of Transfers Varying in Amount

\* \* \* \* \*

Paragraph 10(d)(2)—Range

\* \* \* \* \*

►2. Transfers to an account of the consumer held at another institution. A financial institution that elects to offer the consumer a specified range for debits to an account of the consumer need not obtain the consumer's consent to provide the specified range in lieu of the notice of transfers varying in amount if the funds are transferred and credited to an account of the consumer held at another financial institution. The range, however, must be an acceptable range that could be anticipated by the consumer, and the institution must notify the consumer of the range. ◀

\* \* \* \* \*

Section 205.11—Procedures for Resolving Errors

\* \* \* \* \*

11(b) Notice of Error From Consumer

Paragraph 11(b)(1)—Timing; Contents

\* \* \* \* \*

►7. Effect of late notice. An institution is not required to comply with the requirements of this section for any notice of error from the consumer that is received by the institution later than 60 days from the date on which the periodic statement first reflecting the error is sent. Where the consumer's assertion of error involves an unauthorized EFT, however, the institution must comply with § 205.6 before it may impose any liability on the consumer. ◀

\* \* \* \* \*

11(c) Time Limits and Extent of Investigation

\* \* \* \* \*

Paragraph 11(c)(4) Investigation

\* \* \* \* \*

►5. No EFT agreement. When there is no agreement between the institution and the

third party for the type of EFT involved, the financial institution must review all information within the institution's own records relevant to resolving the consumer's particular claim. For example, a financial institution may not limit its investigation to the payment instructions where additional information within its own records could be dispositive on a consumer's claim. ◀

\* \* \* \* \*

Section 205.16—Disclosures at Automated Teller Machines

16(b) General

Paragraph 16(b)(1)

1. Specific notices. An ATM operator that imposes a fee for a specific type of transaction such as ► for ◀ a cash withdrawal, but not ► for ◀ a balance inquiry, ► or imposes a fee only on some customers, such as those using cards issued by institutions other than the ATM operator, ◀ may provide a general [statement] ► notice ◀ on or at the ATM machine ◀ that a fee [will] ► may ◀ be imposed for providing EFT services or may specify the type of EFT ► or consumers ◀ for which a fee is imposed. ► If, however, a fee will be imposed in all instances, the notice must state that a fee will be imposed. ◀

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By order of the Board of Governors of the Federal Reserve System, September 13, 2004.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 04-20939 Filed 9-16-04; 8:45 am]

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[COTP San Francisco Bay 04-003]

RIN 1625-AA87

Security Zones; Monterey Bay and Humboldt Bay, CA

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to establish permanent moving and fixed security zones extending 100 yards in the U.S. navigable waters around and under all cruise ships, tankers, and High Interest Vessels (HIVs) that enter, are moored or anchored in, or depart from the designated waters of Monterey Bay or Humboldt Bay, California. These security zones are needed for national security reasons to protect the public and ports of Monterey Bay and Humboldt Bay from potential subversive acts. Entry into these security zones would be prohibited, unless specifically authorized by the Captain of the Port