Statement by

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submitted to

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of the

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Mr. Chairman, I am pleased to have the opportunity to testify before this Subcommittee on behalf of the Board of Governors on two bills, S.2096, the "Right to Financial Privacy Act [of 1977"], and S.2293, the "Electronic Funds Transfer Act of 1977." I will begin by summarizing previous comments of the Board on financial privacy legislation.

In mid-July 1975, the Board reported to both Houses of the Congress on several then pending right-to-financial-privacy bills. The Board supported the purpose of these bills and suggested some possible modifications. In July 1975, the Board presented testimony before the House Subcommittee on Financial Institutions Supervision of the House Banking Committee on a broad range of important bank regulatory and supervisory matters, one of which concerned the confidentiality of bank records. At that time, then Governor Robert Holland reiterated the Board's support for the concept of financial privacy legislation.

Late last year, the Board again expressed its views about financial privacy legislation--this time, informally to the House in comments on the "Safe Banking Act," Title XI of which is directed to financial privacy.

Both S.2096 and S.2293 address the issue of financial privacy. S.2096 embodies the basic provisions of earlier versions of financial privacy legislation. I am pleased to add, however, that in our view S.2096 contains significant improvements over those earlier efforts. S.2293 also contains in Section 6 provisions restricting government access to the records of customers of financial institutions.

The Board's consistent position has been that legislation to prevent unwarranted disclosure of individuals' financial records is desirable. We strongly endorse enactment of legislation that will prohibit such disclosures. Although both of the bills before you are consistent with the Board's position, on balance we favor the enactment of S.2096. It appears to us to be a more specific approach in that it prescribes procedures and standards governing disclosure by financial institutions of financial information concerning their customers.

With regard to the specific provisions of S.2096, we believe that the bill's basic prohibition against disclosure to Federal agencies and their employees and agents is not adequate protection for personal financial privacy.

Unwarranted disclosure of a bank customer's records to private persons or concerns also could offer considerable potential for harm -- one that, we believe this legislation should not overlook. For this reason, we recommend that the bill be amended to prohibit unauthorized disclosure of customer financial records to "any person" rather than just to any Federal agency or its personnel. Therefore we recommend that the prohibitions in the bill be expanded to include disclosure to any person to include Federal, State and local agencies and their personnel, as well as private persons and institutions.

However S.2096 also contains provisions in Sections 10, 11, and 17 that might inadvertently inhibit the supervision and regulation of financial institutions. These provisions could be interpreted to impose additional and burdensome recordkeeping requirements on financial institutions with respect to Federal bank examinations, and might also prevent the sharing and exchanging of examination reports among bank supervisory agencies. The Board's staff has prepared a more extensive analysis of these sections of the bill, and has drafted proposed language that we believe will clarify and remove these

difficulties. I have provided the Subcommittee with a copy of this staff memorandum and request that it be included in the record with my testimony.

Turning now to the proposed "Electronic Funds Transfer Act, the need for EFT legislation dealing with the issues considered in this bill has been widely recognized--by the Congress, the Board, the National Commission on Electronic Fund Transfers, and many others. The Board commends your Committee for undertaking this important and challenging task.

EFT Development

EFT promises new services, conveniences and lower payment costs for consumers. In so doing EFT also has the potential to heighten competition among depository institutions, reduce market segmentation, and lessen the burden of the regulatory umbrella under which depository institutions operate. These benefits cannot be fully realized, however, without legislative action. Action by the Congress can speed the process by which the nation will realize the cost savings and convenience that EFT offers. The Board is pleased that S.2293

addresses the important issues surrounding the EFT development and that the bill is consistent, for the most part, with the many recommendations of the National Commission on Electronic Fund Transfers.

The Board believes that any EFT legislation should start from the premise that vigorous competition is in the best interests of consumers and the public. Competition is most likely to develop when there are many participants in the marketplace. Therefore, legislation establishing a legal framework for EFT should make it possible for any and all depository institutions to participate in EFT plans serving their customers. The goal should be to afford individuals, all businesses, and other users of EFT at least the same breadth of choice among alternative suppliers of EFT services that they now have among alternative suppliers of checking accounts. If every depository institution can provide EFT capabilities to its depositors, every depository institution can compete effectively, and competition will generate a broad choice of alternatives for the public.

The Board is pleased to note that Section 2 of S.2293 adopts this philosophy as the overall framework for the bill. Our only comment

on Section 2 is of a clarifying nature. The Board concurs that government involvement or participation in a system competitive with private sector alternatives should be kept to a minimum. But the interdepository institution clearing and settlement functions of EFT may, by their very nature, permit only one or very few clearing systems to develop, as is the case today with most clearing and settlement arrangements for payment items, credit card drafts, and securities. Under such circumstances, government involvement or participation in the provision of inter-depository clearing and settlement services may be necessary if it appears that a sufficient number of competing private sector alternatives are not likely to emerge. As is the case in the check clearing system, government involvement can ensure that a fairly uniform basic level of service is provided nationwide, and that certainty and security of the flow of funds is protected. The latter is an important consideration for the central bank. In addition, all depository institutions can be assured that payment items generated by their customers will be collected expeditiously, thus enhancing the ability of all depository institutions to compete in providing services to their customers.

Because the Federal Reserve provides clearing and settlement payment services only to depository institutions, it does not deal directly with consumers. Therefore, aside from services provided on behalf of the U. S. Treasury to facilitate marketing of Treasury securities, the Federal Reserve does not compete directly with private sector institutions in providing services to consumers and nonbank businesses. Furthermore, the Federal Reserve does not contemplate any deviations from this traditional role of providing clearing and settlement services to financial institutions. We recommend, therefore, that Section 2 be revised to recognize this traditional role of ensuring the efficiency and effectiveness of the payments mechanism.

One further clarifying point concerns the definition of "Customer Terminal" in Section 3. This definition clearly should distinguish between consumers as customers of financial institutions, and institutions as customers of financial institutions. As currently drafted, this definition could unintentionally encompass an institution's

computer within its scope. If this were to occur, it could impede ACH development because Section 8 prohibits the Federal Reserve from offering services involving customer terminals. Since ACH transactions were excluded from the definition of EFT systems, and Section 8 recognizes the role of Federal Reserve providing ACH services, we assume this conflict was not intended.

Branch/Terminal Issue

The Board supports Section 4 of the bill, which closely parallels the recommendations of the National Commission on Electronic Fund Transfers on the Branch/Terminal issue. This issue concerns whether or not EFT terminals should be considered "branches" and therefore governed by State laws applying to brick and mortar branches. We believe that law and regulations should not be applied as restrictively to EFT terminals and that deployment of terminals should be extended to natural market areas to permit competition among depository institutions in the provision of financial services to their customers. We support the objective of increased competition among depository institutions. However, legislation

should ensure that all depository institutions can, in fact, compete effectively in such an environment. For that reason the Board believes that legislation resolving the Branch/Terminal issue should be considered together with any legislative solution to the sharing issue. This is because without a satisfactory resolution to the sharing issue, Section 4 could reduce rather than increase competition among depository institutions.

Some clarifying points on Section 4 may be useful. Section 4 contemplates that only Federally chartered financial institutions will own and operate terminals. It is likely, however, that merchants and vendors also will own and operate customer terminals that are directly linked to financial institutions, and provision should be made in the bill for such arrangements. Further, Section 4 appears to restrict merchants to intrastate banking relationships in accepting deposits which would result from their customers making payments to them at the point of purchase through EFT terminals. If this was intended, it should be noted that the National Commission recommended that merchants should not be limited geographically in selecting the financial institution to receive such deposits.

Sharing

The Board believes that additional consideration should be given to the sharing provisions discussed in Section 5 of this bill because the issues attendant to sharing are very complex and critical to the competitive development of EFT services. These provisions, which generally follow the National Commission's recommendations, will not be effective as a positive force in encouraging the development of EFT and are not likely to promote competition in the provision of financial services to consumers. In esssence, Section 5 of the bill will extend the present uncertainty with regard to the joint establishment and use of EFT facilities by financial institutions. Moreover, the Board's support for Section 4 of this bill is premised upon the assumption that adequate competition will be preserved as depository institutions expand EFT services into natural market areas. Thus, all depository institutions should have a reasonable opportunity to service their customers at EFT terminals across the State lines in natural market areas. Section 5, as drafted, will not ensure this result, because

the present, slow, cumbersome, and expensive litigation remedies relied on in the bill will be ineffective in protecting small and medium sized institutions that may be excluded from shared systems. In addition, Section 5 may establish a positive incentive for only one or a few EFT systems to be developed in each market area to provide services to consumers and merchants, which increases the danger of exclusive arrangements. Access to an EFT terminal should not depend on the identity of the financial institutions issuing an EFT card. Any financial institution willing to comply with reasonable technical standards should be able to issue a card to its customers that will be an acceptable payments instrument at any merchant location equipped to handle EFT items.

At a minimum, the provisions of Section 5 of the bill should be augmented to include more specific statutory standards for sharing. In reviewing sharing arrangements and in settling sharing and access disputes, three factors should be considered: (1) the safety and soundness of the depository institutions, (2) the convenience and needs of the public, and (3) the competitive impact of the sharing arrangement. These principles

have traditionally been of primary importance in assessing actions concerning depository institutions.

Consumer Protection

Section 7 of S.2293 differs significantly from the recommendations of the National Commission on Electronic Fund Transfers on consumer protection and from other EFT consumer protection bills introduced in the Congress. This section proposes that existing check and credit card laws govern EFT transactions. The National Commission concluded that neither check nor credit card law should be strictly applied to EFT and recommended new Federal legislation to remove the uncertainty resulting from the lack of a legal framework of rights and liabilities of participants. On EFT consumer protection, the Commission recommended that new legislation deal with the disclosure of the terms and conditions relating to the use of EFT money transfer accounts, the content of bank statements, proof of payment, liabilities, and errors. The Board indicated in its testimony on S.2065 and H.R. 8753 that it generally supports the Commission's recommendations on consumer protection and the concept of Federal legislation

to resolve these uncertainties. The Board believes that the EFT consumer protection bills currently pending before the Senate Banking Committee provide more extensive protection to consumers than does Section 7 of this bill and suggests that consumer protection concerns be dealt with in the context of these other bills.

Government Operation

Section 8 of S.2293 pertains to government operation of ACH's and POS switches. Paragraph (a) of this section would require that the Federal Reserve provide ACH-type services only to those ACH associations that permit all classes of depository institutions to have membership and full access to association services. The Board supports this requirement, and, in fact, we are pleased that all ACH associations currently admit all types of depository institutions to membership. However, paragraph (a) limits the System to providing ACH-type services only to ACH associations and we do not see any public policy reason for this limitation. We believe that this paragraph should expressly provide that the Federal Reserve may continue its traditional role of furnishing

such services directly to depository institutions or to other organizations composed of such institutions where necessary in order to ensure an efficient and effective payments mechanism. This was also the recommendation of the National Commission.

Paragraph (a) in conjunction with paragraph (c) of Section 8 also would restrict the Federal Reserve from providing other EFT payment and settlement services to financial institutions and other organizations that are not members of an ACH association. This limitation could prevent the Federal Reserve from taking affirmative steps in support of private sector EFT development. For example, the Board recently approved a request from the Bankwire, a privately operated interbank communications firm, to furnish net settlement services to this organization. Provision of this service by the Federal Reserve was recommended by the Department of Justice and others who recognized that such Federal Reserve assistance would promote private sector development of competing payments systems. The restrictions of paragraph (c) would limit the flexibility of the Federal Reserve in providing such payments and settlement services in the future.

Section 8 (b) would require the Federal Reserve to charge, on a fully allocated cost basis, for each service that is furnished to automated clearinghouse associations. We believe that additional flexibility and great caution is necessary in requiring the Federal Reserve to charge for its services. We should be permitted to set prices in the most equitable manner, with due regard to the burden of membership, the inter-relationships among other Federal Reserve payment services, and the public interest. Literally interpreted, Section 8 (b), as drafted, could result in certain areas of the country being effectively excluded from the benefits of EFT because EFT clearing services would be available only at very high cost. The restrictions contained in Section 8 (c) would not permit the Federal Reserve to provide, where necessary, a basic level of EFT clearing services nationwide to serve the public interest, nor aid in the development of ACH payment systems.

Finally, we are pleased that the Section-by-Section Summary which accompanied the bill clearly recognized that the Federal Reserve

may give appropriate credit to member banks for balances held in their reserve accounts. The recommendations of the National Commission on these matters also recognizes the need to give due consideration to member bank balances. The Board strongly recommends that this recognition be explicitly incorporated into the provisions of Section 8, by adding the phrase, "with due regard being given to balances held for such institutions by the Federal Reserve," to Section 8 (b).

Rulewriting

The Board is concerned about Section 9 of the bill that provides for multiple rulewriting authority for chartering agencies. While we believe that chartering authorities should participate in the establishment of standards for the operation of the EFT facilities of their respective institutions, our concern is that overlapping and possibly conflicting standards will add to rather than eliminate much of the current level of uncertainty and that further developments of competition in the EFT area may be inhibited.

Summary

In summary the Board believes EFT legislation would remove much of the uncertainty surrounding EFT and aid in the development of more convenient and cost/effective payment alternatives. We would be pleased to work with the committees in Congress in refining legislation to accomplish this goal.

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Proposed Language Changes to S.2293 by Philip E. Coldwell
June 1, 1978

Where suggested language changes to existing sections of S.2293 are minor, the new wording is underlined and the wording to be deleted is enclosed in brackets. Where a new section, subparagraph, or a replacement for an existing section are suggested, there is no underscoring.

Section 2

The Congress finds that the extension of electronic funds transfer systems can benefit consumers in a number of significant ways, and that affording maximum consumer and user convenience and choice in access to and use of both funds transfer and credit-extension services will serve the public interest. The Congress wishes to promote competition among financial institutions and other business enterprises using electronic funds transfer systems and services, and to insure that Government regulation and involvement or participation in [a system competitive with the private sector is kept to a minimum] the provision of EFT services to financial institutions fosters such competition. The Congress further finds that the public interest in preventing unfair or discriminatory practices in the field of electronic funds transfer services, in preserving competition among users, and in reducing costs of such services, is best achieved by the removal of inappropriate geographical restrictions on terminal deployment and service offerings. [and by insuring that Government facilities or services do not displace private sector alternatives.]

Rationale

The suggested language recognizes the possibility that Government involvement or participation in the provision of wholesale EFT services may foster competition in the provision of retail EFT services to consumers by insuring that the wholesale services necessary to clear and settle items

generated by consumers are available to all financial institutions on equitable terms. The goal of legislation should be to foster competition, not to determine whom the providers are.

Section 3 (a),(b),(c),(d) No change

Section 3 (e),(1),(2),(3) No change

Section 3 (e),(4)

"Point-of-sale" terminal means an electronic device owned and operated by a retailer or its agent and used to communicate information or instructions regarding a customers transaction to its financial institution.

Rationale

The current definition of electronic funds transfer system seems to omit point-of-sale terminals.

Section 3 (f),(g),(h),(i),(j),(k) No change

Section 3 (l)

"Customer" means a natural person.

Rationale

The term customer is not defined in the bill. An example of the problems this creates is found in the definition of "customer terminal" and Section 8. The definition of customer terminal fails to distinguish between consumers and institutions as customers and therefore has significant implications on Federal Reserve ACH operations, because Section 8 of the bill prohibits the Federal Reserve from offering any EFT services which are connected in any way to customer terminals. One could interpret this to mean that the Federal Reserve could not offer on-line ACH services. That is, a corporation's computer could be defined as a customer terminal. This could impede the flow of funds among institutions and slow ACH development if the computers of banks or institutions were considered to be customer terminals.

Section 3 (m)

"Debit services" means arrangements which enable a customer to have a debit charged to his account at a financial institution.

Rationale

The definition of "debit services" is required since it is introduced in Section 5 in order to clarify the nature of shared operations.

Section 4 (a),(b),(c),(d) No change

Section 4 (e)

A retailer or its agent may own or operate a point-of-sale terminal to communicate information regarding a customer transaction to its financial institution.

Rationale

The present language of S.2293 does not seem to recognize that retailers will own and operate electronic terminals.

Section 5 (a)

The application of the antitrust laws to the establishment, operation, sharing, or use of electronic funds transfer shall be limited only to the extent provided in part (c) of this Section, and shall not be limited or restricted in any way by the terms or existence of State legislation or regulation. Any State legislation or procedure which purports to mandate access to or the use of an electronic funds transfer system by persons or entities not entitled thereto through agreement with the proprietor thereof is hereby expressly pre-empted and nullified.

(b) A system proprietor providing deposit services or debit services through a customer terminal to the customers of more than one financial institution that are not affiliates of the same holding company must offer such services to the customers of all financial institutions upon the same terms and conditions, except that the terms and conditions may vary if the cost of providing the services to the customers of different financial institutions varies. However, the charge for providing such services must reasonably approximate their cost. Furthermore, while no system proprietor is hereby required to provide the same level of service to the customers of all financial institutions, system proprietors must insure that all debits and credits presented to their system are expeditiously forwarded to the proper financial institution for posting to customer accounts.

A system proprietor need not extend access to customer terminals to customers of financial institutions where those institutions cannot meet the reasonable technical standards of the system proprietor that are met by other financial institutions. Debit services provided by any electronic funds transfer system need not be accepted by any person in payment of obligations due to that person.

(c) If a financial institution which is unable to obtain access to an electronic funds transfer system decides to pursue the remedies which may be available to it under the antitrust laws, it may bring a civil action against the system proprietor in the judicial district in which is located the principal place of business of the plaintiff or of the defendant, or in any judicial district in which the defendant is doing business. In every case, the court shall take into consideration the

financial and managerial resources and future prospects of the financial institutions involved, and the convenience and needs of the community to be served.

(d) Every proceeding in the United States district courts in accordance with subsection (c) shall be given precedence over other cases on the docket of the court, and shall be assigned for hearing and trial at the earliest practicable date and expedited in every way.

Rationale

Paragraph (a) is rewritten to reflect the Commission's recommendation that state mandatory sharing laws be pre-empted.

The intent of paragraph (b) of Section 5 as proposed here is to ensure that competition will develop among financial institutions so that EFT can provide a payment facility equivalent to the paper check both in availability and in acceptability to consumers and to merchants. To this end, access to an EFT terminal should not depend, as far as is practicable, on the identity of the financial institutions issuing an EFT card. Any financial institution willing to comply with reasonable technical standards should be able to issue a card to its customers that will be an acceptable payments instrument at any merchant location equipped to handle EFT items. Processing of such payments items would be the responsibility of those system proprietors who have offered their services to the customers of more than one financial institution. A proprietor that wishes to operate a system only for the customers of a single financial institution or for the customers of financial institutions affiliated with the same holding company, would not be required to process EFT items generated by cards issued by unaffiliated financial institutions.

Requiring system proprietors to process expeditiously all items presented to their terminals will encourage competition among financial institutions issuing EFT cards, while not precluding competition among EFT systems. As in the check system, merchants are expected to arrange with financial institutions and/or EFT systems to collect items generated by the merchant's business. EFT systems accepting all cards would be able to compete with one another by providing improved service to merchants. In addition, the system proprietor could have an associated EFT card of its own that would provide customers with a package of services, one of which would be the processing of EFT items. Such service lines, if made attractive to consumers, would induce financial institutions to acquire use of the system proprietor's EFT card. Thus, system proprietors could compete both in offering services to merchants that handle all cards and in providing EFT cards and other service lines to consumers through financial institutions. An EFT system proprietor entering a market, offering an attractive line of services for consumers or merchants or both would be in an excellent competitive position even though the System was required to collect expeditiously the EFT items generated by all cards.

Under this provision merchants are expected to treat EFT payments items in much the same way that they treat checks, cash, and other payments media. Because expeditious processing of such items would be assured, merchants would have no reason to differentiate among cards presented by consumers unless a particular financial institution were to operate its EFT plans in a way that disadvantaged the merchant. For example, cards that did not meet the reasonable technical standards of the merchant's EFT

provider, or cards that imposed excessive charges for the services provided, could be refused by a merchant, at the merchant's sole option. Similarly, individuals who use EFT in an irresponsible manner could have a debit card refused by a merchant or a transaction refused by either the EFT system or the individual's financial institution, just as paper checks of certain individuals with a poor payment record are currently unacceptable for payment even though the checks or drafts of that individual's financial institution are generally acceptable to merchants.

The intent of paragraph (c) of Section 5 as proposed here is to ensure that the convenience and needs criteria embodied in the Bank Merger and Holding Company Acts are considered along with antitrust law in any judicial proceedings that result from contested sharing arrangements.

Paragraph (d) is unchanged.

Section 6 Delete

Rationale

Privacy legislation seems better suited to separate legislation such as S.2096.

Section 7 Delete

Rationale

Consumer protection seems better suited to separate legislation such as S.2546 which is now under consideration by the Senate.

Section 8 (a)

The Federal Reserve banks may provide the basic level of ACH-type services necessary to clear and settle batched electronic payments between financial

institutions or organizations composed of such institutions. The Federal Reserve banks may not, however, furnish such services to an automated clearinghouse association or other similar organizations if such association does not extend membership and full access to its services to all financial institutions on comparable terms.

Rationale

Section 8 (a) would seem to limit the Federal Reserve to providing ACH-type services to automated clearinghouse associations only. It would seem desirable from a competitive point of view for the Federal Reserve to provide ACH-type services to other organizations and institutions, such as member banks, credit union associations, etc., as well as ACHs. The NCEFT recognized this and the suggested language closely parallels the NCEFT's recommendations in this area.

Section 8 (b)

Each Federal Reserve Bank may, in accordance with rules prescribed by the Board of Governors of the Federal Reserve System, levy charges on depository institutions using Federal Reserve ACH services, with due consideration being given to balances held for such institutions by the Federal Reserve.

Rationale

Paragraph 8 (b) may unduly restrict the responsibility of the Federal Reserve to meet the Nation's payment system needs and to insure the efficiency of our Nation's payment system. The NCEFT was cognizant of this and the suggested alternative language for this paragraph more closely parallels the recommendations of the NCEFT.

Section 8 (c) Delete

Rationale

This provision does not reflect the position of the NCEFT. The NCEFT recommended that at the present time the Federal Government should not be involved operationally in POS switching and clearing facilities except for the provision of net settlement but did suggest that government involvement at some future date may be appropriate. This was not a legislative recommendation, however, and the NCEFT specifically recommended that government involvement in POS not be foreclosed. Therefore paragraph (c) of Section 8 does not reflect the position of the NCEFT because it ignores the NCEFT's recommendation that legislation not completely foreclose government involvement in the clearing and settlement of POS transactions, and goes further than the NCEFT suggested by including EFT systems other than POS.

Section 9 (a)

The appropriate supervisory agencies shall prescribe regulations which provide common standards for the establishment, operation, sharing and use by Federal financial institutions of electronic funds transfer systems consistent with the provisions of this Act.

Rationale

The multiple rulewriting authority provided for in Section 9 is likely to result in disparate rules for the establishment, operation, sharing, and use of EFT systems. Such a result would probably impede rather than foster competition among depository institutions. The suggested language is designed to remedy this problem.

Section 10 No change