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STATEMENT BY

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS
OF THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

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Mr. Chairman, I am glad to have this opportunity to participate on behalf of the Board of Governors in your Committee's hearings on consumer safeguards for electronic funds transfer systems. The need for such safeguards has been recognized by the Congress, the Board, the National Commission on Electronic Funds Transfer, and many other representatives of the general public. The Board commends your Committee for undertaking this essential work. These issues are of vital importance to consumers.

The new world of electronics provides opportunities to broaden consumer payment alternatives and to improve consumer convenience and service while reducing the costs of making payments. Direct deposit of Government payroll and social security benefit payments through automated clearing houses has helped people receiving funds by improving the security and convenience of such payments and has resulted in substantial cost savings to the Government. Installation of teller machines by the financial institutions has offered consumers longer banking hours and more convenient banking facilities at costs much less than regular branches. The retailing industry has successfully installed electronic cash registers that have demonstrated the convenience and cost savings expected of EFT at the point of purchase.

Nonetheless, EFT is developing at a more moderate and cautious pace than many predicted. The major reasons for this slow development are found in the many uncertainties that surround the substitution of electronic systems for the traditional use of paper bills, checks, receipts, and ledgers. Consumers, businessmen, and depository institutions are unsure of their rights and liabilities in EFT systems. There also may be antitrust questions that need to be clarified since cooperation among competing depository institutions may be necessary in many markets to successfully introduce the new technology. It is not surprising, then, that we are applying only a fraction of the technology we possess and that businesses are reluctant to make the substantial investment necessary to utilize present know-how.

Clearly, the work of this Committee can speed the process by which we can realize the cost savings and conveniences that our inventive technology can bring to the simple, normal daily tasks of life.

H.R. 8753 addresses consumer rights and interests, and is directed at quieting many of these fears. The Board endorses the intent of the proposed EFT consumer legislation. EFT can deliver substantial public benefits. Many of the issues covered by H.R. 8753, as you know, have

also been considered by the National Commission on Electronic Funds Transfer in that Commission's detailed deliberations. While the proposed bill has benefited from the Commission's earlier Interim Report, I am sure the Committee will want to review carefully the Commission's final recommendations on consumer issues. As you know, these have been completed within the past two weeks. Finally, H.R. 8753 recognizes but does not appear to address consumer privacy, a most important issue. The Commission has considered the privacy issue extensively, and I suspect this Committee will want to study the subject carefully.

The Board believes that consumer protection legislation should start with the premise that keen competition is an aid to consumers when both suppliers and purchasers are numerous. 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 set up EFT plans for their customers. The goal should be to afford individuals, small 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. Limits on the ability of institutions to offer EFT plans, whether imposed by legislation or by the nature of EFT technology, could result in the same sort of highly concentrated market that characterizes the bank credit card industry. Such an outcome would probably not be in the public interest.

H.R. 8753's most important provisions deal with the information the institution supplies to the consumer and the substantive rights of the consumer. The Board particularly supports the advance disclosure of EFT terms in readily understandable language. Disclosure would cover both the consumer's right to obtain information from the institution and the consumer's rights when something goes wrong. The Board believes disclosure of transaction terms is necessary as it will facilitate the consumer's control over his personal finances. The Board also endorses the concept of descriptive periodic statements describing the activity that has taken place in the consumer's account and recommends that the statements should include the transaction date, amount, location, means of transfer, type of transaction, other parties to the transaction, and transaction number.

These statements are particularly important because they will serve many of the functions now being provided by cancelled checks.

The Board also approves of H.R. 8753's definition of certain inherent consumer rights, such as a limit on liability for unauthorized use of funds transfer cards, the right to stop payment on a purchase transaction, as well as the right to require prompt correction of errors.

The Board endorses the limit proposed in H.R. 8753 on a consumer's liability for unauthorized transfers by means of an EFT card. This provision parallels the earlier Board recommendations. Unauthorized uses of EFT cards, beyond minimal amounts, represent avoidable or insurable risks which the Board believes institutions, not consumers, are better able to bear.

The Board similarly approves the provision in H.R. 8753 which makes the institution liable for consequential damages suffered by the consumer as a result of a failure to carry out transactions ordered by the consumer. Under the present check payment system, a bank "is liable to its customers for damages proximately caused by the wrong dishonor of" a check.^{1/} Thus, if the consumer writes

^{1/} UCC section 4 - 402

a check to pay for a fire insurance premium on a home, the bank erroneously refuses to pay it, the insurance coverage lapses for nonpayment, and the home burns down, the bank is liable for the damages incurred by its customer, not just for the amount of the check. This same principle should apply to consequential damages suffered because of EFT lapses by the institution.

The Board further supports the provision in H.R. 8753 that gives the customer the right to stop EFT transactions. The EFT customer's right to stop payment on purchase transactions is quite similar to the customer's present right to stop payment on a check. The stop payment right was originally included in the Uniform Commercial Code on the grounds that depositors "expect and are entitled to receive (this right) . . . notwithstanding its difficulty, inconvenience, and expense."^{2/} The same rationale applies to EFT transactions. However, stop payment transactions will probably occur infrequently, and significant costs to the consumer may be associated with them. Therefore, Congress may want to consider alternatives, such as "value dating," a system that permits the consumer and the merchant to agree on a future date on which a payment will become final.

^{2/} UCC section 4 - 403, n.2.

No one doubts that both mechanical and human errors will occur under an EFT system. Consumers have a particular reason under EFT to expect prompt error correction. Errors may reduce or deplete the funds in the consumer's account needed for day-to-day living expenses. The Board, therefore, favors H.R. 8753's provisions concerning error resolution and the requirement that statements contain sufficient identifying information to enable the consumer to detect mistakes. The error resolution procedure derives in part from the Fair Credit Billing Act. In H.R. 8753 the institution must acknowledge alleged errors within seven days and correct such errors within 30 days. That may not be feasible for EFT. In the case of credit errors the consumer must decide only whether or not to pay an erroneous bill. When the consumer is confronted with errors in his deposit account, however, he may be temporarily without funds. The Board believes that 37 days is too long for a consumer to be without his funds, and that the error resolution period should be substantially shortened.

I also want to bring to the Committee's attention other basic concerns of the Board. They are the risk that the bill could have of anticompetitive effects and could increase costs that EFT systems should reduce.

Vigorous competition between financial institutions constitutes an important form of consumer protection. H.R. 8753's prohibition upon circulation of EFT cards which consumers have not requested can impose a substantial barrier to supplier entry into the EFT market. The new EFT institution faces more difficult start-up problems than even that experienced by a credit card issuer. A large base of cardholders is essential to attract merchant participants. Without such a base of participating merchants, consumers will not find the system attractive. In urging reconsideration of the ban on unsolicited credit card distribution, I want to point out that the abuses that occurred in the mid-1960s when regional, three-party credit card systems were being established can now be controlled. Consumers enjoy the protection of error resolution and strictly limited liability. We should not recreate the extreme concentration that presently exists in the credit card industry in "debit" or EFT cards.

I hope the Committee will revisit this issue which has been so controversial. Under the bill, the consumer bears no liability for unauthorized use of an EFT card unless the consumer requested and received the card. Thus, all liability for unauthorized use of

unsolicited cards appropriately rests with the institution instead of the consumer. Further, there may be a worthy compromise in permitting the unsolicited distribution of EFT cards, while requiring that the access code necessary for the card's use be sent only if the customer accepts the plan.

Of equal importance is the resolution of questions that will be raised governing the use of shared systems. While it is not in H.R. 8753, surely Congress will want to give considerable attention to this issue. EFT should serve the consumer by presenting as few barriers as possible to the consumer's access to all advantages of the network. Consumers should be able to make a purchase from any merchant willing to accept their EFT card, regardless of which institution has issued the card. The consumer can get little benefit from his EFT account if he cannot use his card in a store having a terminal because the switching network will not accept the transaction.

H.R. 8753 seeks to assure that the check payment system will continue as an alternative to EFT. The Board supports the retention of the checking alternative, but opposes the provisions in the bill that require institutions to charge as much for their EFT services as for checks.

Both consumer protection and overall competition will be better served if price competition remains unrestricted so that consumers can realize any cost savings available through EFT. A policy of competitive pricing would parallel the recent interest in unbundling of bank charges and Truth in Lending's authorization of discounts for cash.

The Board's concern about legislation prohibiting price competition requires me to comment on the provision that affects charges for credit. We are opposed to this type of Federal price fixing. It invades the business decision flexibility of sellers and would supplant or conflict with much State legislation.

Another issue of particular interest to the Board is the effect of the proposed bill on the cost of electronic payment services to the consumer. H.R. 8753 would require that EFT generate written documentation of virtually all transactions: sales, loans, debits, and credits. The cost of this broad requirement could nullify the benefits and conveniences EFT offers. A requirement of such records at the point of sale or loan appears reasonable. Simply handing a receipt to the consumer

presents few logistical problems, entails no mailing costs, and permits the EFT institution to obtain the user's signature for potential comparison to the account holder's in the event of a disputed transaction. However, concurrent mailing of a record of a nonpoint of sale or loan transaction to the consumer involves significant costs. Since the transaction will generate no consumer signature, the degree of protection afforded the consumer by this procedure has limits. The Board, therefore, wonders if the nonpoint of sale or loan transaction, particularly a periodic deposit or preauthorized transfer, warrants the expense of concurrent documentation, when it may result in so little additional consumer protection, but will add substantially to costs. The Board suggests that negative notice, failure by an institution to receive a regular automatic deposit, for example, would provide sufficient consumer protection against missed transfers, at greatly reduced cost.

The Board's interest in reducing the cost of electronic payment services to the consumer also extends to notice requirements. H.R. 8753 would compel institutions and credit card issuers to include with their respective cards a notice to the effect that Federal law

prohibits the distribution of unsolicited cards. Even if this Committee decides not to reconsider the Board's recommendation that Congress repeal or alter the ban on unsolicited cards, the Board believes that the very slight degree of protection conferred on consumers by this notice requirement may not justify the expense, confusion, and paperwork associated with printing, enclosing, and mailing the notices.

The Board's interest in the reduction of costs also applies to recent proposals to replace descriptive billing for open-end credit with a requirement that the creditor enclose copies of written receipts with periodic statements. The Board has experience with some consumer complaints about descriptive billing such as inadequate or misleading identification of transactions. On balance, the Board believes that the loss of information by non-return of receipts and the occasional inconvenience at having to request copies will not outweigh the increased paperwork and cost involved in their automatic collection, sorting and return.

Many people feel that EFT proponents have focused attention upon EFT issues involving technology and marketing and have not paid sufficient heed to safeguarding consumers.

H.R. 8753 is a most important step to balance these concerns. That is the reason I have offered the Board's strong support for the work of this Committee on many of the key provisions in the bill. Comments urging further study on consumer privacy issues, the possible anticompetitive effects of shared systems, and the costs to the consumer of producing duplicate records are offered in the spirit of helping the Committee improve the legislation. The Board believes that many of these problems can be resolved after further careful study. With your approval, Mr. Chairman, I plan to submit a technical appendix for the record offering appropriate suggestions for some of the points I have raised this morning.

I hope these comments have been helpful and I will be pleased to try to answer whatever questions you may have.

Thank you.