



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

DALLAS, TEXAS 75222

September 10, 1987

Circular 87-64

TO: The Chief Executive Officer of all
member banks and others concerned in
the Eleventh Federal Reserve District

SUBJECT

Amendments to Regulation E -- Electronic Fund Transfers

DETAILS

The Board of Governors of the Federal Reserve System has amended its Regulation E, Electronic Fund Transfers (EFT). The amendments eliminate the periodic statement requirement for certain providers of EFT services that do not hold consumer accounts. The amendments, which were proposed in August 1986, are designed to facilitate the development of point-of-sale electronic fund transfer services that make use of the ACH system without imposing substantial regulatory compliance costs on financial institutions. Certain modifications to the August 1986 proposal are contained in the Board's final rule to respond to some of the concerns raised in the comments; they are intended to minimize further the potential costs to account-holding financial institutions and the possibility of consumer confusion.

The amendments are effective November 15, 1987.

ATTACHMENTS

A copy of the material as published in the Federal Register is attached.

MORE INFORMATION

For further information, please contact Dean Pankonien of this Bank's Legal Department at (214) 651-6228. If you wish to receive additional copies of this circular, please contact our Public Affairs Department at 651-6289.

Sincerely yours,

FEDERAL RESERVE SYSTEM

12 CFR PART 205

[Reg. E; Docket No. R-0578]

Electronic Fund Transfers

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has amended the requirements applicable under Regulation E to electronic fund transfer (EFT) services initiated by non-account-holding financial institutions (at point of sale, for example) and processed through the automated clearing house system for debiting to a consumer's account. The amendments eliminate the periodic statement requirement for persons that provide EFT services to consumers, but do not hold consumer accounts, if they

(1) Issue a debit card to the consumer that includes an address or telephone number to be used by the consumer to contact the service provider;

(2) Send information needed to identify the transaction in accordance with Regulation E (including the terminal location) to the account-holding financial institution; and

(3) Extend the time periods available to the consumer for notice of errors and lost or stolen debit cards, and give certain additional disclosures.

The amendments will also require account-holding financial institutions to include a description of these EFT transactions on periodic statements provided to their customers.

These amendments were made in response to requests from financial institutions and from service providers, current and potential. Changes to the regulation were proposed by the Board

last August (51 FR 28589, August 8, 1986). The amendments should facilitate the development of point-of-sale EFT services that make use of the automated clearing house system for processing, without imposing substantial compliance costs on financial institutions or significantly reducing consumer protections.

DATES: *Effective Date:* November 15, 1987.

However, to facilitate compliance for account-holding institutions, disclosure of the terminal location will not be required until July 1, 1990. In addition, account-holding institutions with assets of \$25 million or less will not be required to comply with any aspect of the regulation as to these transactions (except to cooperate with the service provider in the investigation of errors) until July 1, 1990.

FOR FURTHER INFORMATION CONTACT: Regarding the regulatory changes, contact: Gerald P. Hurst or John C. Wood (Senior Attorneys), Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, (202) 452-3667. Regarding the regulatory analysis, contact Frederick J. Schroeder (Economist), Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, DC 20551, (202) 452-2584. For Telecommunications Device for the Deaf (TDD) users only, contact: Earnestine Hill or Dorothea Thompson, (202) 452-3544.

SUPPLEMENTARY INFORMATION:

(1) Background

The Electronic Fund Transfer Act (EFTA) (15 U.S.C. 1693 *et seq.*), implemented by Regulation E (12 CFR Part 205), establishes the basic rights, liabilities, and responsibilities of consumers who use electronic fund transfer (EFT) services and of financial institutions that offer such services:

The primary objective of the act is to provide individual consumer rights. The act and the Board's Regulation E require financial institutions, for example, to give initial disclosures concerning their EFT services and to provide receipts and periodic account statements. The act and regulation also limit consumer liability for unauthorized EFTs and require institutions promptly to investigate and resolve consumers claims of EFT errors. In part, Congress had in mind that providing these and other safeguards was important to build public confidence in EFT systems (and thus help ensure their development).

At the same time, the statute requires the Board, in prescribing regulations, to

take into account and allow for the continuing evolution of electronic banking services and the technology utilized in such services; and to analyze the effects of the Board's regulations on competition in the provision of electronic banking services among large and small financial institutions, and on the availability of such services to different classes of consumers. The Board is also directed, to the extent practicable, to demonstrate that the consumer protections outweigh the compliance costs. (Section 904(a) of the EFTA.)

The EFTA applies to all types of EFT services provided to consumers. These include debits and credits to consumers accounts through the automated clearing house (ACH) system: telephone bill-payment and home banking services; automated teller machine transactions; and debit-card transactions made at point of sale (POS). The EFTA applies principally to account-holding financial institutions (AHFIs), but Section 904(d) of the act also directs the Board to cover in its regulations other providers of EFT services. The regulation carries out this statutory directive by also covering "any person who issues an access device and agrees with a consumer to provide electronic fund transfer services." (Section 205.2(i) of Regulation E.)

Often the person providing the service—the service provider—and the AHFI join together to offer an EFT service. In such cases the parties will usually contract between themselves to ensure that the obligations imposed by the act and regulation are carried out. But if there is no agreement, the regulation allocates the responsibilities between the service provider and the AHFI. Basically, the regulation requires service providers to comply with all the requirements of the act and regulation that relate to the EFT service.

In recent years, there has been growing interest in an alternative to direct debit, on-line systems for processing point-of-sale transactions, one that makes use of the automated clearing house system. Use of the ACH enables a service provider to access consumer accounts at different financial institutions without having to enter into a specific agreement with *each* AHFI on which it may be collecting funds.

Typically, a POS/ACH service will involve a retailer and a traditional financial institution such as a bank. The retailer, or a bank on the retailer's behalf, will issue the consumer a debit card and personal identification number (PIN). The consumer, in turn, furnishes the retailer with the checking-account number and the AHFI's routing number. In the POS/ACH system, when the

consumer uses the debit card to make a transaction at point of sale, the transaction is not immediately posted to the consumer's account, as is often the case in direct debit, on-line systems. Instead, the transaction data are initially stored by the retailer (or the retailer's bank) and batched with other transactions; later, the transaction data are sent through the ACH for collection.

In the past several years, the Board has received inquiries about the Regulation E responsibilities of service providers offering POS/ACH services. The inquiries have focused primarily on the requirement governing periodic statements.

The regulation requires service providers to give consumers a periodic statement at least monthly if EFTs have been made by the consumer and quarterly if no EFT has occurred. Typically, the statement given by the service provider will contain the following information regarding transfers made with the debit card issued by the service provider:

- The consumer's account number.
- Information about each transfer made during the cycle—the amount of the transfer, the date the transfer was made by the consumer, the type of transfer, the location of the electronic terminal, and the name of the payee.
- The amount of any fees or charges for transfers.
- The address and telephone number to be used for inquiries or notice of errors.

(2) The Board's August 1986 Proposal

Service providers and financial institutions interested in developing POS/ACH systems asked the Board to eliminate the periodic statement requirement. They believed that, because of the costs involved, the necessity of sending periodic statements impedes the growth of POS/ACH systems. They said that the requirement is particularly onerous for an institution such as a grocery store or other retailer that does not customarily send customers a periodic statement. They also believed such a statement is unnecessary, and claimed that its cost exceeds the consumer benefits. Much of the information, they noted, also appears on the periodic statement received by the consumer from the AHFI.

In August 1986, the Board published for public comment a proposal to amend Regulation E (51 FR 28589, August 8, 1986) to eliminate the periodic statement requirement for service providers if they met certain conditions. The Board also proposed to require AHFIs to include

descriptions of the POS/ACH transactions on their periodic statements to consumers. (Because Regulation E, until now, has imposed no documentation requirements on AHFIs for POS/ACH transactions, AHFIs currently may show only the amount of the debit and the posting date on periodic statements.) The Board proposed to require AHFIs to identify the service provider as the recipient of the funds debited and to give the terminal location—information that would be received through the ACH.

In publishing the proposal for public comment, the Board suggested that the proposed changes would:

- Eliminate a requirement that may pose a barrier to the development and use of POS/ACH systems (thus limiting new EFT services to consumers).

- Provide continued consumer protection by ensuring that consumers receive certain information from service providers on receipts or in periodic notices, and by ensuring that the detailed transaction identification is on the AHFI's periodic statements.

- Result in benefits to consumers, service providers, and financial institutions, without imposing substantial compliance costs on AHFIs. The Board expressed special interest, however, in hearing from commenters about the effects that the proposed changes might have on AHFIs, particularly small institutions. The Board's notice specifically solicited comment on compliance costs.

The Board received approximately 350 comments on the proposal; about 65 percent of them opposed the changes. But although the majority of financial institutions and almost all of the financial institution trade associations opposed the changes, many banks and other financial institutions supported them. Even among institutions of similar size, there were those that opposed and those that favored the proposal.

The institutions opposing the proposed amendments believed that they would result in increased costs to AHFIs and would reduce consumer protections. They also suggested that the proposal was unfair since it would remove a cost of offering EFT services for service providers, while increasing the cost for some AHFIs. In addition, some institutions were concerned that facilitating POS/ACH development would limit their opportunities to increase usage of the direct debit, on-line systems—in which the institutions have invested large sums of money—for processing POS transfers.

Other commenters were of an opposite view. They believed the

proposed changes would benefit development of EFT services, particularly at the point of sale. Some commenters also expressed the opinion that encouraging POS/ACH systems would benefit smaller institutions that can not afford to develop or join a direct debit, on-line program.

Many institutions had difficulty determining the position that would be in their best interest. This was due in part to the fact that the effects of the proposed changes are difficult to predict with any degree of certainty. Some institutions were divided on the proposal since their retail and wholesale divisions took different positions. The retail divisions of financial institutions operate most of the EFT systems that provide consumer services—including the direct debit, on-line systems that support automated teller machine programs. They were generally concerned that the proposed changes would result in their systems not being used for EFTs at the point of sale. The wholesale divisions, on the other hand, offer EFT services to commercial entities, including automated clearing house services. They viewed the proposed changes as making it easier to develop POS/ACH systems that they could offer to corporate customers, some of whom have expressed an interest in this area.

(3) Discussion of Comments and Analysis

After a review of the comments and further analysis of the issues, the Board has amended Regulation E to make the changes that were proposed. Though it is difficult to predict whether elimination of the service-provider periodic statement requirement will in fact lead to widespread adoption of electronic payments by consumer's, the Board believes that keeping the requirement is clearly inconsistent with this goal. The Board continues to believe that the potential costs to service providers of sending periodic statements is a significant impediment to the development and offering of POS/ACH services by some entities (such as grocers and other retailers that do not currently provide periodic statements).

The information given on the service provider's statement is, to a great extent, duplicative of information on the statement the consumer receives from the AHFI. The Board believes that the information that is not duplicative (in particular, the address and telephone number to be used for reporting problems) can be given to the consumer by the service provider effectively, and at a much lower cost, through additional disclosures on debit cards and on

transaction receipts. With these increased disclosures, there should be no significant reduction in the protections now afforded consumers under the EFTA and Regulation E.

The compliance costs to AHFIs for capturing and furnishing the required information to consumers can be minimized by providing a long transition period in which institutions can make the operational changes needed to provide the transaction data on periodic statements.

The amendments that the Board has adopted include modifications to the August 1986 proposal. These modifications respond to some of the concerns raised in the comments; they are intended to minimize further the potential costs to AHFIs and the possibility of consumer confusion. The modifications are discussed in the material that follows. However, other concerns raised in the comments—such as the increased costs from returned ACH items and the monitoring of accounts with transaction limitations—do not result from the proposed changes to Regulation E. In the Board's opinion, these concerns are best addressed by the industry and market forces, and not by regulation.

1. Periodic Statement Costs

Under the amendments, all AHFIs will have to identify POS/ACH transactions on their periodic statements in accordance with Regulation E. Currently, they have no such obligation under Regulation E, although some institutions have the capability and do so. As a practical matter, all financial institutions probably post the amount and the date on which they debit the consumer's account, just as they do for checks. Under the amendments, AHFIs will have to identify the transfer by showing (in addition to the amount and date) the name of the payee and the terminal location.

Some commenters suggested that any increased operational costs resulting from the proposed changes would be small. They maintained that most financial institutions currently offer EFT services and, as a result, already have systems in place that are capable of capturing and furnishing transaction data to the consumer in accordance with Regulation E.

Many other commenters, however, claimed that the required changes to periodic statements would result in substantial costs to AHFIs. Frequently mentioned were costs related to operational changes needed for AHFIs to furnish transaction identification information. These commenters

maintained that financial institutions that handle their data processing in-house will incur expenses in modifying their systems to process the Regulation E transaction information. Operational changes may be necessary, for example, to enable institutions to capture the data, to retain it for the length of the cycle, and to print it on the consumer's periodic statement. Financial institutions that use a service bureau for transaction processing may not incur costs for systems changes, but may be charged higher fees by their service bureau.

A number of commenters addressed the impact that the proposal might have on small institutions. Most of these commenters believed that the proposal would have a disproportionately adverse impact on small institutions due to their limited ability to absorb the added compliance costs. Some commenters singled out certain small institutions, that do not currently have to comply with the regulation, as particularly disadvantaged by the proposal. Regulation E now provides an exemption for preauthorized transfers to or from an account held by a financial institution with assets of \$25 million or less. (Preauthorized transfers include, for example, debits such as insurance premiums to an insurance company, and credits such as salary payments deposited by an employer). Thus, if the institution's involvement in EFT is limited to accepting preauthorized ACH items, it is not currently subject to Regulation E.

Based on the comments and the issues raised, the Board notes that the impact on individual institutions probably depends on the extent to which the institution is now participating in EFT programs. Many institutions currently give periodic statements that comply with Regulation E's transaction description requirements.

In addition, because of recent developments, participants in the ACH network are already subject to identification requirements parallel to those that will be imposed by the amendments to Regulation E. The National Automated Clearing House Association (NACHA)¹ last year

amended the rules governing POS/ACH transfers, effective April 6, 1987. The revised NACHA rules call for financial institutions that originate POS/ACH transfers to provide to account-holding institutions all of the information that will be required by the Board's changes to Regulation E. (That is, the originating institutions must send detailed information through the ACH so that receiving institutions can describe transactions in accordance with Regulation E.) The rules also call for the receiving institutions to provide consumers with the transaction descriptions required by Regulation E, including the terminal location, on periodic statements.

It is also clear that many financial institutions are not now capturing the terminal location for inclusion on periodic statements. Although these institutions have been receiving ACH transactions for some time (for example, direct deposit of payroll) they have not had to capture any data carried in the ACH "addenda record"—the additional data that accompany the payment record portion of the ACH transaction. (The addenda record contains, among other things, the terminal location for POS/ACH transactions.) Among them, some institutions now have the operational capability to do so, others do not.

Modifications to Proposal. Although many financial institutions already provide other EFT services that require them to comply with Regulation E, listing the terminal location for POS/ACH transfers could be a problem for some of them. The comments and the results of a survey carried out by the Federal Reserve Banks earlier this year support this conclusion. Consequently, the Board has modified the proposal to minimize the impact of the regulatory changes for AHFI's.

The Board believes that any problems and costs associated with compliance will be significantly reduced if AHFI's have a sufficiently long period of time to implement the changes. Therefore, the Board is giving account-holding financial institutions until July 1, 1990, to capture and print the terminal location on periodic statements. Given the speed with which technological developments are occurring, many institutions will be making a significant number of other changes to their computer systems over the next several years. The delayed effective date for disclosure of the terminal location will enable them to implement the operational modifications as they make these other systems changes.

In addition, because the regulatory changes could have a disproportionately greater adverse impact on very small financial institutions, the Board is exempting institutions with assets of \$25 million or less from compliance with all regulatory requirements for POS/ACH transactions until July 1, 1990. As noted earlier, Regulation E currently exempts from coverage preauthorized credits and debits received by these institutions. Extending this exemption to POS/ACH transfers on a temporary basis will ensure that many small institutions whose EFT involvement is limited to the acceptance of items through the ACH—will continue to have no compliance responsibility under the regulation for the next three years. Again, this action will make it possible for institutions to develop a compliance program and make whatever operational changes need to be made, either in their internal programs or those of an outside processor, over an extended period.

Service providers have not been given a comparable delay for complying with the revised regulation. Service providers will have to transmit the terminal identification for POS transfers in order to take advantage of the exception from the periodic statement requirement. This transmittal will benefit both AHFI's and consumers. It will allow AHFI's that are now capable of capturing the information and printing it on periodic statements to do so, thereby possibly avoiding some questions about transactions. And even if an AHFI chooses not to print the location on the statements during the transition period, it will have the information for reference purposes in case of inquiries.

The Board believes that modifying the periodic statement requirements and providing long lead times for AHFI's to comply fully with the regulation will not significantly reduce consumer protections. The number of POS/ACH programs that are currently in place, and likely to be in place in the next few years, is small.

2. Error Resolution Concerns

A periodic statement given to an EFT customer serves multiple purposes. It summarizes the electronic transfers that have taken place during the statement period, and allows the consumer to verify the accuracy of the entries. The statement also contains the address and telephone number to be used if the consumer has a question, finds an error, or needs to report unauthorized transfers or the loss or theft of a debit card. In many cases, the statement also may contain a brief description of the

¹ NACHA is the national rule-making organization for the automated clearing house network. Through member ACH associations, thousands of financial institutions and corporations have contractually agreed to be bound by the *NACHA Operating Rules and Guidelines*. In addition, the *NACHA Operating Rules* are incorporated into each Federal Reserve Bank's Uniform Operating Circular on Automated Clearing House Items.

error resolution procedures available under the EFTA.

With the adoption of these amendments to Regulation E, consumers will receive periodic statements, identifying the recipient of a POS/ACH transfer, from the AHFI rather than the service provider. They will not, however, be receiving a monthly reminder of the telephone number and address to be used for inquiries, error allegations, or reports of lost or stolen cards.

The Board's August 1986 proposal sought to avoid potential consumer problems by requiring service providers that did not issue periodic statements to make increased disclosures to consumers—both in their initial disclosure statements and on receipts or quarterly notices. In addition, the proposal called for extended time periods for consumers to give service providers notice of errors or lost or stolen debit cards. (Without an extension of the time periods, consumers who mistakenly notified the AHFI of a problem could face increased liability for unauthorized EFTs and the risk of losing certain error resolution rights.)

Nonetheless, some industry commenters expressed concern that the proposed changes might lead to consumer confusion about error resolution responsibility. (No comments were received from any consumer groups or individual consumers.) They suggested that this could result in frustration for consumers when AHFIs are unable to resolve an alleged error that began with the service provider. They thought it would also impose a burden on the AHFI, which could face substantially increased costs for responding to consumer inquiries and error allegations about the service provider's EFT service. Many also suggested that, without a periodic statement from the service provider, consumers might find it more difficult to verify or audit POS/ACH transactions. Other commenters believed that even though the service provider has the sole responsibility to resolve POS/ACH transaction errors, AHFIs would probably also, as a practical matter, become involved in the dispute resolution process. Since the AHFI's telephone number, not the service provider's, would appear on the periodic statement being given, it was considered likely that the consumer would address inquiries to the AHFI. In addition, because AHFIs will want to maintain good customer relations, they will likely attempt to resolve problems for their customers.

In analyzing the potential impact of the proposed changes in Regulation E, it is necessary to separate problems and concerns that might be caused by elimination of the periodic statement from those that will exist in any event. The fact is that any debit transaction, whether by check or POS/ACH, will result in funds being taken from an account held by the AHFI. As a result, consumers are likely to call the financial institution holding their account if an error occurs, whether or not the service provider has given a periodic statement.

Modifications to Proposal

The Board believes that, in the interest of AHFIs and consumers, it is important to minimize the possibility that consumers look to the AHFI as the party responsible for the POS/ACH service. The proposal sought to do so through increased initial disclosures and reminders from the service provider on receipts or quarterly notices. The Board has made two modifications to the proposal to further ensure that the consumer will know whom to notify in case of a problem.

The first modification is to require the service provider to issue its own debit card to consumers, and to include on the card its name and an address or telephone number that may be used to contact the service provider. The fact that the POS/ACH service uses a card issued by the service provider, not the AHFI, will avoid the perception of AHFI responsibility that might result if a service provider could offer a service using a card issued by the AHFI. In addition, the consumer will have readily available an address or telephone number for contacting the service provider.

The second change also relates to the telephone number and address. The proposal would have given service providers the option of putting this information on receipts or in a quarterly notice. The Board has amended the regulation to require that the information be given on each receipt. (The act and regulation already require all financial institutions that offer EFT services to give consumers an annual notice of error resolution rights, unless a summary notice is included on each periodic statement.)

The additional information on the debit card, on receipts, and in initial disclosures should clearly and adequately inform the consumer that the service provider is responsible for the POS/ACH service and is to be notified in the event of a problem. As a result, the possibility that consumers will be confused when an error occurs and will mistakenly look to the AHFI for

resolution should not be a significant problem.

3. Other AHFI Costs

A few commenters maintained that significant costs could result in other areas. Several commenters indicated that institutions would incur additional costs to return ACH items that overdraw accounts, and suggested that the number of returns would probably increase. A number of commenters said that it would be expensive to monitor accounts to ensure that transaction limitations under Regulation D are not exceeded.

The Board agrees that if POS/ACH systems become widespread and transaction volume increases, the potential exists for increased problems of the types cited by the commenters. However, since a few retailers are currently offering point-of-sale services using the ACH, AHFIs already face some costs for returning ACH items, monitoring accounts that have transaction limitations, and responding to consumer inquiries and error resolution requests. Also, it is not the issuance or nonissuance of a periodic statement by the service provider that gives rise to these costs; the costs result primarily from the fact that AHFIs hold the consumers accounts being debited for POS/ACH transfers.

Moreover, if the industry acts to ensure that systems are set up properly, while POS/ACH systems are still in their infancy, the difficulties can be minimized. For example, if the originating financial institution (the one setting up a POS/ACH system for a retailer) makes sure that the retailer gives customers access only to a checking or other transaction account, AHFIs will not experience the problem of receiving POS/ACH transfers on non-transaction accounts.

In the end, AHFIs and other participants in the system are free to charge for the services that they provide and to recover the costs they incur. The Board believes that continuing to require that a service provider give a periodic statement is not the answer to these potential problems.

4. Other Concerns

Security. Some of the commenters expressed concern about added risk to the security of EFT systems and individual access devices if Regulation E were amended. They believed the proposal could indirectly result in a lessening of consumer confidence in EFT systems, in general, if problems were to arise. The reason most often given for these concerns was that service providers might permit consumers to use

an access device issued by the AHFI to access accounts through the POS/ACH system. These commenters feared that, in such a case, the service providers might fail to implement adequate safeguards in the system—for example, encryption of personal identification numbers.

The Board's requirement that service providers issue their own debit cards, as a condition to not giving periodic statements, should alleviate some of these concerns. As a practical matter, because the consumer's liability for unauthorized transfers is limited and the AHFI has none in this case, it is the service provider that bears the risk of loss for unauthorized POS/ACH transfers. Thus, there is a substantial basis for believing that service providers will act in their own interest to develop secure systems.

Consumer Liability and Costs. Under the EFTA and Regulation E, the consumer's liability for unauthorized use of an access device is determined by the promptness with which the consumer reports the loss or theft of the device. Liability is limited to \$50 if the consumer reports within 2 business days after learning of the loss or theft. It can increase to \$500 for unauthorized transfers that take place after 2 business days if the consumer delays reporting (and may be unlimited for unauthorized transfers taking place more than 60 days after unauthorized transfers appear on a statement). Some commenters suggested that the proposed regulatory changes could result in increased losses for consumers. If a consumer is confused about who is responsible for the POS/ACH service, the consumer might initially notify the wrong party about the loss or theft. Substantially higher dollar losses could occur as a result, because the consumer could easily miss the 2-business day deadline.

The Board believes that the actions taken to ensure that the consumer knows whom to notify in case of errors will be equally effective in ensuring that the consumer will notify the service provider when a debit card is lost or stolen. In addition, the amendments provide for longer time periods for notification of a lost or stolen card for these POS/ACH transactions. Consumers should not be exposed to increased liability for unauthorized EFTs under the amendments.

Another concern raised was that the proposal would lead to increased costs for consumers, as AHFIs passed on costs incurred as a result of the regulatory changes. Supporters of the proposal, on the other hand, felt that the proposed changes would benefit consumers, since the cost of payment

processing should fall as POS/ACH arrangements become more widespread. These savings would be passed on to consumers in the form of lower priced goods and services, for instance.

AHFIs do of course have the option of passing on costs related to POS/ACH transfers by imposing fees for account services. A consumer would then have various choices: pay the new transaction fees imposed by the AHFI, discontinue use of the POS/ACH service, or, if fees varied among institutions, change AHFIs. There is also evidence to suggest that the availability of the POS/ACH payment alternative may offer consumers the chance to pay a lower price for purchases when using this payment option. For example, at least one gasoline company plans to give customers the cash discount price when they pay with a debit card.

Fair Competition. Many commenters complained that the proposed changes would give service providers an unfair competitive advantage over AHFIs in the offering of EFT services by reducing costs for service providers while increasing costs for AHFIs. A large number of them believed that the proposal would *not* provide any benefits to AHFIs, and only a few suggested that the proposal might result in increased competition.

By facilitating the development and implementation of POS/ACH systems by service providers, the regulatory changes could increase competition in the offering of EFT services. On balance, it is not clear that they will significantly increase existing burdens for AHFIs. Nor is it clear that the changes will create *no* benefits for AHFIs. In the long run, the substitution of EFT transactions for check transactions should result in lower costs to financial institutions.

(4) **Summary.** In conclusion, the Board is adopting in final form the proposed changes to Regulation E that were published in August 1986. To address some of the concerns expressed by the commenters, the Board is modifying certain requirements and imposing additional conditions on service providers. The Board is delaying implementation of certain aspects of the proposal in order to minimize the compliance costs to AHFIs.

The following is a summary of the amendments to Regulation E adopted by the Board:

(1) A service provider—a person that issues an access device and agrees to provide EFT services to a consumer, but has no agreement with the consumer's account-holding financial institution—will not be required to issue a periodic statement summarizing the transactions made if it:

(i) Issues a debit card that bears the name of the service provider and an address or telephone number that can be used by the consumer to contact the service provider, and

(ii) Provides detailed transaction data to the AHFI in the format prescribed by the ACH system, so that the AHFI can comply with the transaction identification requirements of Regulation E.

(2) To take advantage of the exception from the periodic statement requirement, the service provider will also be required to do the following:

(i) Provide the consumer with certain additional information in initial disclosure statements,

(ii) Include the telephone number and address for reporting errors and notice of lost or stolen cards on or with terminal receipts, and

(iii) Extend the time period for reporting a lost or stolen debit card under § 205.6(b)(1) from 2 business days to 4 business days, and extend the time periods under § 205.6(b)(2) and § 205.11(b)(1) from 60 days to 90 days.

(3) AHFIs will be required to describe POS/ACH transactions on consumer periodic statements in accordance with the transaction identification requirements of Regulation E, except that the terminal identification need not be given until July 1, 1990. In addition, financial institutions with assets of \$25 million or less will not be required to comply with any requirements as to POS/ACH transactions until July 1, 1990.

5. Regulatory Analysis

The amendments to Regulation E are primarily intended to facilitate the long-term development of electronic fund transfer systems by eliminating duplication of certain documentation currently provided to consumers. By eliminating the periodic statement requirement for service-providing institutions (such as supermarkets, gasoline retailers, and other merchants) that are not the holders of consumer transaction accounts, the amendments will eliminate some duplication of information. Because consumers will continue to receive periodic statements reflecting electronic fund transfers to and from their accounts, they will experience no loss of information or required documentation. Consequently, there will be no elimination of consumer benefits associated with the periodic statement requirements of the act. Potential cost savings to non-account-holding service providers and to the payments system as a whole are likely to be substantial.

1. Effect on Account-Holding Financial Institutions

The cost burden of providing the additional information is not likely to be great for AHFIs as a group. Most POS transactions will involve accounts at financial institutions that already are able to comply with the periodic statement requirements of the act and regulation. Available evidence indicates that 79 percent of all commercial banks already offer at least one EFT service that requires compliance with Regulation E, and larger banks, which hold most consumer asset and transaction accounts, are even more likely to offer EFT services.²

The amendments are not expected to lead to a significant increase in the number of periodic statements that AHFIs will have to deliver to consumers. Most depository institutions already provide monthly periodic statements for transaction accounts. The economic burden for each institution will depend, in part, on its ability to disclose the required information on those statements. Some institutions will also have to devote additional resources to data processing, error resolution, and other functions. The aggregate incremental economic burden on AHFIs as a group is expected to be small in comparison to other compliance costs associated with Regulation E.³ Nonetheless, certain AHFIs may incur substantially increased costs from having to include additional information in periodic statements, and some institutions will have to issue periodic statements more often.

Financial institutions may be able to recover some of the increased compliance costs directly from consumers. Account-holding institutions may choose to assess charges on consumers who use debit cards issued by service providers.⁴ Whether such

² As of December 31, 1986, banks with assets of \$100 million or more held over 84 percent of all U.S. banking assets. More than 96 percent of those banks already offer at least one EFT service that requires compliance with Regulation E.

³ Board staff conducted a survey of financial institutions in 1981-82 to determine the magnitude of Regulation E compliance costs. The survey revealed that postage and printing or purchase of statements accounted for 27 percent of total ongoing compliance costs, and that development of statement forms and disclosure documents accounted for 11 percent of start-up compliance costs. See Frederick J. Schroeder, *Compliance Costs and Consumer Benefits of the Electronic Fund Transfer Act Recent Survey Evidence*, Staff Study no. 143, Washington, DC: Board of Governors of the Federal Reserve System, April 1985.

⁴ Similar charges are already commonly assessed when a consumer uses an ATM not owned or operated by his or her financial institution. The average service charges per transaction for various kinds of ATM transactions performed on other

charges will be assessed is not known because pricing actions will ultimately reflect competitive market conditions.

Concerns about the ability of payment system participants to send, receive, and process the required disclosure information are mitigated by recent developments in EFT message interchange standards. Significant progress has been made toward standardization of electronic debit and credit items. In early 1987, the National Automated Clearing House Association (NACHA) introduced new rules that require all financial institutions that participate in the ACH to identify point-of-sale transactions in accordance with the requirements of Regulation E. This development ensures that electronic items originated through the ACH include all information required for account-holding institutions to make periodic statement disclosures in compliance with Regulation E.

2. Effect on Small Financial Institutions

It does not appear that small financial institutions as a group will be unduly disadvantaged by the amendments. Many small institutions, because they already participate in automated teller machine networks, currently are able to comply with the periodic statement requirements of the act and regulation. In any case, small institutions not currently able to disclose the required information with their periodic statements are likely to be able to get assistance at reasonable cost from their correspondent banks or from service bureaus that specialize in data processing applications for small financial institutions.

Furthermore, to mitigate the compliance burden that might arise, the Board is exempting all small institutions (those with assets of \$25 million or less) until July 1, 1990, from providing any new documentation required by the changes.⁵ Similarly, all institutions, regardless of size, are exempted until July 1, 1990, from the requirement to disclose the physical location of point-of-sale terminals involved in EFT transactions; among the changes, that disclosure requirement appears to

institutions ATMs are detailed in the *1986 Retail Deposit Services Report*, Washington, DC, American Bankers Association, March 1986, table 126.

⁵ As of December 31, 1986, 4,697 commercial banks (34 percent), 8 mutual savings banks (2 percent), 572 savings and loan associations (17 percent), and 14,773 credit unions (92 percent) had total assets of \$25 million or less. While large in number, those small institutions together controlled only 3 percent of the total assets of U.S. financial institutions and, consequently, a small share of total consumer transaction accounts that might be affected by Regulation E.

present the most burdensome implementation problem to financial institutions in general. The exemptions give institutions approximately three years to come into full compliance with the changes.

3. Effect on Service Providers

For service-providing institutions (such as supermarkets, gasoline retailers, and other merchants) that issue debit cards but do not hold consumer accounts, the cost savings resulting from the amendments are expected to be substantial. Service providers will be able to offer point-of-sale services to consumers without having to enter into agreements with each financial institution holding consumers accounts. In addition, to the extent that payments cleared through the ACH are less costly than other methods of payment, service providers will be better able to convert transactions from cash, check, and credit card payments to electronic point-of-sale payments.⁶

The greatest economic benefit of the amendments is expected to arise in the future as the volume of POS transactions increases. More potential service providers are likely to be able to justify offering consumers POS services as a result of the amendments. It is expected that the amendments will have a salutary effect on the evolution of the payments system by reducing the average system-wide compliance cost per POS transaction.

By eliminating periodic statements for service providers, the amendments are expected to provide a substantial economic benefit through cost savings to service providers and to the payments system as a whole. The amendments will standardize the way in which documentation of EFT point-of-sale transactions is provided to consumers by requiring that AHFIs disclose all the required information. To ensure that their customers are informed about procedures for error resolution, service providers are required to inform consumers, in expanded disclosures, of the telephone number and address consumers should use to report transaction errors or lost or stolen debit cards.

⁶ For a discussion of the costs of ACH and other means of payment, see David B. Humphrey, *The U.S. Payments System: Costs, Pricing, Competition and Risk*, Monograph Series in Finance and Economics, no. 1984-1/2, New York: Salomon Brothers Center for the Study of Financial Institutions, Graduate School of Business, New York University, 1984.

4. Effect on Competition

Some commenters alleged that the amendments would give service providers an unfair competitive advantage over financial institutions in the provision of point-of-sale EFT services. While statement issuance costs for service providers will be eliminated, and compliance costs for financial institutions as a group are likely to increase, the overall effect on competition is not clear. Financial institutions currently provide to consumers basic documentation of transactions from their accounts that are initiated electronically at point of sale and sent by ACH; the additional documentation required by the amendments may be viewed as a service enhancement, and consumers may be willing to pay for it through fees or other account-pricing mechanisms. To the extent that such ACH items substitute for and are cheaper to clear than paper checks, financial institutions may enjoy a long-term reduction in the cost of clearing consumer payments. Furthermore, many financial institutions may be able to profit from the wholesale provision of ACH clearing to service providers that issue POS debit cards. It is expected that market forces will guide both service providers and financial institutions to the optimal supply and pricing of various consumer payment alternatives. However, an immediate effect of the amendments may be to place some financial institutions at a cost disadvantage in their competition with service providers.

5. Effect on Consumers

Available evidence suggests that consumers are satisfied with their EFT accounts. Board-sponsored consumer surveys conducted in 1981 and 1983 showed that the number of account errors and unauthorized transfers is negligible both in absolute terms and relative to the volume of EFT transactions occurring in the payments system.

Data from the Board's Consumer Complaint Control System offer further evidence that consumers have no serious problems with EFT. Of the 2,400 complaints processed in 1986, 94 involved electronic fund transfers. The Federal Reserve System forwarded 32 of those complaints to other agencies for resolution; of the remaining 62, only 2 involved a possible violation of Regulation E.

Because the amendments ensure that consumers will continue to receive all the disclosures required by Regulation E, consumers will experience no loss of information and, consequently, no

reduction in the benefits intended by the act.

6. Conclusion

On balance, the amendments are expected to rationalize the way in which consumers receive the periodic statement disclosures required by Regulation E. With the amendments, the payments system as a whole is likely to realize significant cost savings as electronic point-of-sale transactions increase in volume and relative importance. Consumers are likely to benefit from lower transaction costs and increased efficiency in the payments system as the volume of electronic point-of-sale transactions increases. Moreover, with the amendments, there will likely be no loss of the consumer protections provided by the act.

List of Subjects in 12 CFR Part 205

Banks, Banking, Consumer protection, Electronic fund transfers, Federal Reserve System, Penalties.

Regulatory Text

Pursuant to the authority granted in section 904 of the Electronic Fund Transfer Act, 15 U.S.C. 1693b, the Board amends Regulation E, 12 CFR Part 205, as follows:

PART 205—[AMENDED]

1. The authority citation for Part 205 continues to read as follows:

Authority: Pub. L. 95-630, 92 Stat. 3730 (15 U.S.C. 1693b).

2. Section 205.14 is amended by revising paragraphs (a)(2) and (b) as follows:

§ 205.14 Services Offered by Financial Institutions Not Holding Consumer's Account.

(a) *Compliance by service-providing institution.* * * *

(2) Sections 205.7, 205.8, and 205.9 shall require the service-providing institution to provide those disclosures and documentation that are within its knowledge and the purview of its relationship with the consumer. The service-providing institution need not furnish a periodic statement to the consumer under § 205.9(b), if the service-providing institution:

(i) Issues a debit card, to be used by the consumer to initiate electronic fund transfers, that bears the name of the service-providing institution and an address or telephone number that can be used to contact the service-providing institution;

(ii) Transmits the applicable transaction identification information specified by § 205.9(b)(1) to the

consumer's account-holding institution, in the format prescribed by the automated clearing house system used to clear the fund transfers;

(iii) Discloses to the consumer, in addition to the information required by § 205.7, that the service-providing institution (not the account-holding institution) is responsible for all electronic fund transfers made with the debit card, and that all inquiries and error notices related to such transfers should be directed to the service-providing institution; that the service-providing institution will not issue a periodic statement, and that the consumer should retain all terminal receipts to verify transactions; and that the consumer must notify the service-providing institution concerning loss or theft of the debit card;

(iv) Provides on or with the receipts required by § 205.9(a) the address and telephone number to be used for inquiries and error notices and for reporting the loss or theft of the debit card; and

(v) Extends the time period set forth in § 205.6(b)(1) for notice of loss or theft of a debit card, from 2 business days to 4 business days after the consumer learns of the loss or theft; and extends the time periods set forth in §§ 205.6(b)(2) and 205.11(b)(1) for reporting unauthorized transfers or alleged errors, from 60 days to 90 days following the transmittal of a periodic statement.

* * * * *

(b) *Compliance by account-holding institution.* An account-holding institution described in paragraph (a) of this section need not comply with the requirements of the act and this regulation with respect to electronic fund transfers to or from the consumer's account made by the service-providing institution, except that the account-holding institution shall:

(1) Comply with § 205.9 by providing a periodic statement and describing each transaction from the service-providing institution that is debited or credited to the consumer's account in accordance with § 205.9(b);¹³ but the account-holding institution has no liability for failure to provide this information if the failure is due to its not having received the necessary information from the service-providing institution in the prescribed format; and

¹³ Account-holding institutions shall not be required to furnish the terminal location as part of the transaction description until July 1, 1990. In addition, account-holding institutions with assets of \$25 million or less shall not be required to comply with section 205.9(b) until July 1, 1990.

(2) Comply with § 205.11 by promptly providing to the service-providing institution, upon its request, information or copies of documents required for the purpose of investigating alleged errors or for furnishing copies of documents to the consumer; and by honoring debits to the account in accordance with § 205.11(f)(2).

* * * * *

3. Appendix A is amended by revising the introductory language and by adding section A(11) as follows:

APPENDIX A—Model Disclosure Clauses

This appendix contains model disclosure clauses for optional use by financial institutions to facilitate compliance with the disclosure requirements of §§ 205.5 (a)(3), (b)(2), and (b)(3), 205.6(a)(3), 205.7, and 205.14(a)(2).

* * * * *

SECTION A(11)—Disclosure From Service-Providing Institution That Does Not Send Periodic Statements (§ 205.14(a)(2))

ALL QUESTIONS ABOUT TRANSACTIONS MADE WITH YOUR (NAME OF CARD) CARD MUST BE DIRECTED TO US (NAME OF SERVICE PROVIDER), AND NOT TO THE BANK OR OTHER FINANCIAL INSTITUTION WHERE YOU HAVE YOUR ACCOUNT. We are responsible for the (name of service) service and for resolving any errors in transactions made with your (name of card) card.

We will not send you a periodic statement listing transactions that you make using your (name of card) card. The transactions will appear only on the statement issued by your bank or other financial institution. SAVE THE RECEIPTS YOU ARE GIVEN WHEN YOU USE YOUR (NAME OF CARD) CARD, AND CHECK THEM AGAINST THE ACCOUNT STATEMENT YOU RECEIVE FROM YOUR BANK OR OTHER FINANCIAL INSTITUTION. If you have any questions about one of these transactions, call or write us at (telephone number and address) (the telephone number and address indicated below).

IF YOUR (NAME OF CARD) CARD IS LOST OR STOLEN, NOTIFY US AT ONCE by calling or writing to us at (telephone number and address).

By order of the Board of Governors of the Federal Reserve System, August 12, 1987.

William W. Wiles,

Secretary of the Board.

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