

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7354]
March 6, 1974

PROPOSED REVISION OF REGULATION J
— Extension of Period for Public Comment to April 8
— Questions and Answers to Clarify Proposal

To All Banks, and Others Concerned,
in the Second Federal Reserve District:

Following is the text of a statement issued today by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today extended until April 8 the period for public comment on the basic structure of the Nation's payments mechanism and its proposed regulatory changes relating to electronic funds transfer. The deadline for comment had originally been set for March 8.

The Board's public notice, announced on November 19, 1973, invited comment on proposed changes in Regulation J (check collection) and on the basic questions concerning ownership, operation and allocation of the costs of an electronic payments mechanism. Several requests for an extension of the comment period have been received by the Board.

At the same time, the Board issued the attached series of questions and answers designed to clarify the intent of the November proposals and to dispel misunderstandings that have arisen about them. These questions and answers are not intended to be exhaustive or technical responses to specific inquiries.

The text of the Board of Governors' proposal to expand Regulation J is contained in our Circular No. 7274, which was sent to you on November 20, 1973. Comments thereon should be submitted by April 8, 1974, and may be sent to our Payment Systems Department.

Printed below is the text of the series of questions and answers referred to in the above statement.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

Questions and Answers
Relating to the Board's Proposal of November 19, 1973
To Amend Regulation J
Covering Clearance of Checks and Electronic Transfer of Funds

The Board's proposal of November 19, 1973, would expand Regulation J which currently governs the use of Federal Reserve facilities to collect checks. The existing Regulation J would become *Subpart A* of the expanded regulation. *Subpart B* would set forth the rules and procedures now contained in the operating circulars of the Federal Reserve Banks that govern the use of the Federal Reserve Communications Network for credit transfers. *Subpart C* would provide a legal framework for use of Federal Reserve facilities to collect funds electronically.

QUESTIONS RELATING TO SUBPART B —
CREDIT TRANSFERS

1. *What type of credit transfers are envisioned under Subpart B?*

Subpart B makes no change in the present treatment of the large-dollar-value credit transfers now sent on the Federal Reserve Communications Network. However, Subpart B would contain the framework for handling large numbers of wage, salary, retirement or other income payments. For example,

this part of the Board's proposal would permit a business to pay its employees by crediting wages to their bank accounts. This would be done in the following manner:

— A business would provide its bank with a magnetic tape containing payroll information for the employees to be paid by the business.

— The bank serving the business would use this information to credit employees' accounts maintained in the same bank.

— Credits contained on the magnetic tape for accounts in other institutions would be sent to a Federal Reserve office. This office would disperse the payroll information to other institutions used by the company's employees. The Federal Reserve Communications Network would be used to send this information to other Federal Reserve offices which service institutions used by the company's employees. The Federal Reserve office receiving this information would send it to the individual financial institutions in the form of magnetic tape, punched cards, or hard copy. This is the practice used in the automated clearing house (ACH) arrangements in San Francisco, Los Angeles and Atlanta.

2. *Under the definition section of Subpart B, a "transferee" is defined to include "or other institutions maintaining an account on the books of a Federal Reserve Bank." What is the significance of this phrase?*

This phrase appears in the Federal Reserve Act and is used in existing Federal Reserve regulations. It covers Edge Act Corporations and government departments and agencies. Inclusion of this phrase in Subpart B does *not* indicate any intent by the Board to extend the use of nonmember clearing accounts.

3. *One section of Subpart B (paragraph 210.59(b)) provides up to 10 business days for the holder of a Federal Reserve clearing account to challenge written advice of a charge made to his account resulting from a credit transfer. Why is such a lengthy period provided?*

The Board is reconsidering this provision in the light of public comments received in response to the Regulation J proposal.

QUESTIONS RELATING TO SUBPART C — DEBIT TRANSFERS

4. *What is the anticipated use of Subpart C?*

Subpart C would permit a member bank to originate small-dollar-value debit items for collection

through the Federal Reserve Communications Network in much the same way that income payment credit transfers would be made. The proposed expanded regulation would permit the efficient processing of large numbers of small payments which occur on a regular basis, such as the payment of utility bills, mortgage payments and payments on installment debt. Under the regulation, it would be possible for a member bank, at the direction of a customer, to send debit items directly to a Federal Reserve office for collection. A bank participating in an automated clearing house using Federal Reserve facilities would send debit items to the ACH on magnetic tape. The ACH would sort-out the items addressed to banks in the territories of other Federal Reserve offices and then transmit the items through a member bank over the Federal Reserve Communications Network. Debit items in the area covered by the ACH would continue to be handled by the ACH.

5. *On whose authority would an ordering bank initiate a debit item?*

All participants must agree beforehand to the collection of funds by electronic means. This is what is meant by the authorization and warranty discussed in Subpart C (paragraph 210.75). These prior agreements are necessary since the impetus for a debit transfer originates with a creditor, rather than the holder of an account.

Before any debit item transfer, the ordering bank will warrant that the creditor who originates the transfer has obtained the agreement of the payors for collection in this manner, and that if the payor objects the transaction may be reversed. The proposed regulation will be amended to require such warranty, and the warranty and agreement process will be spelled out in Reserve Bank operating circulars.

There are two alternative methods that may be utilized for handling preauthorized debit entries. One such method is for the holder of an account to file a written authorization with his bank stating that his account may be charged for the benefit of a creditor in a stated amount or for a stated purpose. The account holder is, of course, free to rescind this authorization at any time or to close his account in that institution, thus in effect rescinding authorization. A second alternative method, which substantially reduces the amount of paper work required, was developed in connection with automated clearing house arrangements. Under this alternative, the customer has 45 days to rescind any debit transaction in his

account and thus is not required to file a preauthorization agreement with his bank.

The warranty agreements envisioned would be similar to arrangements now in place in the check collection system. For example, a consumer now can make an arrangement which authorizes his insurance company to originate a "preauthorized" instrument for the collection of insurance premiums at stated intervals, and for his commercial bank to debit his account for the amount indicated on the collection instrument. After the agreements are in place, the instrument is prepared at a set interval by the insurance company and is paid by the consumer's bank based upon the preauthorized agreements.

GENERAL QUESTIONS

6. *Who may originate debit and credit items under the legal framework proposed in Subparts B and C?*

Under Subpart B, credit items may be sent to a Federal Reserve office for transmission on the Federal Reserve Communications Network by member banks, the U. S. Treasury, Edge Act and Agreement Corporations, Federal Reserve Banks, international organizations, foreign correspondents, and other institutions authorized by Reserve Banks.

Under Subpart C, debit items may be originated and sent to a Federal Reserve office for transmission on the Federal Reserve Communications Network by member banks and Federal Reserve Banks. Other financial institutions could participate in these arrangements through a member bank.

7. *Who may receive debit and credit items under the legal framework proposed in Subparts B and C?*

All commercial banks and thrift institutions authorized by State or Federal law having regular or special routing numbers may receive debit and credit items through a member bank.

8. *Are telephone instructions acceptable under Subpart B of the proposed revised regulation?*

Yes, at the option of the Federal Reserve Bank.

9. *Are the proposed modifications to Regulation J associated with an earlier informal proposal to collect by wire all checks of \$10,000 and over?*

The \$10,000 and over check proposal has no bearing on the proposed modifications to Regulation J. The proposed regulation does not provide *operating* rules for converting checks to electronic funds transfers.

10. *Currently, there is a \$1.50 charge to member banks for credit transfers of less than \$1,000 on the Federal Reserve Communications Network. Will this charge continue under the operational framework proposed in Subparts B and C?*

Whether the Federal Reserve should charge for the use of its facilities, and under what conditions, are issues raised for comment in the Regulation J publication. The \$1.50 charge was extended to discourage use of the wire facility for small transfers. The proposed regulation would make possible large volumes of such transfers, provided they are fully automated. Hence, the previous charge has no relevance to this proposal.