FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8619
August 8, 1979]

AMENDMENT TO REGULATION E — ELECTRONIC FUND TRANSFERS

Written Notice of Loss of EFT Card Effective When Mailed or Otherwise Transmitted

*To All Banking Institutions, and Others Concerned,
in the Second Federal Reserve District:*

The Board of Governors of the Federal Reserve System has adopted an amendment to its Regulation E, "Electronic Fund Transfers," that makes written notice of loss or theft of an electronic fund transfer card effective when the consumer mails or otherwise transmits the notice.

Following is the text of the Board's announcement:

The object of the amendment to Regulation E—which implements the Electronic Fund Transfer Act—is to assist consumers in limiting their potential loss due to unauthorized use of an EFT card to not more than $50. The amendment seeks to avoid exposure of the consumer to greater loss due to delays in the mail or other delays in delivery of written notice.

Regulation E also provides that notice can be given orally, by telephone or in person.

The EFT Act provides that a consumer's liability for unauthorized use of an EFT card is limited to $50 if the consumer notifies the card issuer within two business days of learning of loss or theft of the card, or unauthorized use. Potential liability rises to $500 if notification occurs after two business days. If the consumer fails to notify the card issuer within 60 days after transmittal of a periodic statement that shows unauthorized use of the EFT card, the consumer's liability may be unlimited for transfers made after the 60 days.

In testimony to the Congress on May 1, 1979, the Board suggested a single liability limit for unauthorized use of an EFT card.

Enclosed is a copy of the Regulation E amendment, which has been adopted as proposed in May. The amendment is effective September 10, 1979. Questions regarding Regulation E may be directed to our Consumer Affairs Division (Tel. No. 212-791-5919).

THOMAS M. TIMLEN,
First Vice President.

Board of Governors of the Federal Reserve System

ELECTRONIC FUND TRANSFERS

AMENDMENT TO REGULATION E

(effective September 10, 1979)

Written Notification of Loss or Theft of Access Device

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting an amendment of § 205.5(c) of Regulation E, which implements the Electronic Fund Transfer Act, to provide that written notice of loss or theft of an access device or possible unauthorized electronic fund transfers is effective at the time the consumer mails or otherwise sends the notice to the financial institution. The regulation now provides that written notice is effective upon receipt of the notice by the financial institution (or upon expiration of the time normally required for transmission, if earlier). An analysis of the economic impact of the amendment is included as item (3) of the supplementary information.

EFFECTIVE DATE: September 10, 1979.

FOR FURTHER INFORMATION CONTACT: Regarding the regulation: Lynne B. Barr, Senior Attorney, Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2412). Regarding the economic impact analysis: Frederick J. Schroeder, Economist, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2584).

SUPPLEMENTARY INFORMATION: (1) *Proposed Amendment; Summary of Comments.* On March 21, 1979, the Board adopted sections of Regulation E (Electronic Fund Transfers) to implement §§ 909 and 911 of the EFT Act (44 FR 18468, March 28, 1979). Section 205.5 of the regulation sets limits on a consumer's liability for unauthorized transfers. Generally, a consumer's liability for such transfers is limited to $50 if the consumer notifies the financial institution within 2 business days of learning of the loss or theft of the access device, and to $500 if notification occurs after 2 business days. Liability can be unlimited, however, if the consumer fails to notify the institution within 60 days after transmittal of a periodic statement that reflects unauthorized transfers.

Section 205.5(c) implements § 909(a) of the Act, which states that notice to a financial institution of loss or theft of an EFT access device or possible unauthorized transfers is considered given when the consumer takes such steps as are reasonably necessary to provide the institution with the pertinent information. The Act contemplates written or oral notice. The Board, when adopting the regulation, added a sentence which provides that written notification is effective upon receipt of the notice by the financial institution, or upon expiration of the time normally required for transmission, whichever is earlier.

The Board believed that consumers will usually notify the institution in person or by telephone, rather than in writing, in order to minimize potential losses. Telephone notification is the quickest and most efficient means of telling an institution of a lost or stolen EFT card. To encourage such notification, the Board's model disclosure clause emphasizes the advisability of telephone notification.

The Board received a number of comments on the "receipt rule" after its adoption. These comments pointed out that the liability structure of the EFT Act and Regulation E operates in a manner that may increase a consumer's liability significantly when the consumer notifies the institution in writing of the possibility of unauthorized transfers. A notice mailed by the

For this Regulation to be complete, retain:
1) Regulation E pamphlet, effective March 30, 1979, as amended August 1, 1979.
2) This slip sheet.

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consumer immediately upon learning of the loss or theft of the card may not be received by the financial institution within 2 business days. The consumer would thus be subject to the $500 liability limit (instead of the $50 limit imposed if notice is received within 2 business days). This is in contrast to the operation of a similar receipt rule in Truth in Lending, where a delay in receiving written notice would not increase a consumer's liability above the $50 statutory maximum.

As a result of these comments and the Board's concern over this escalating liability, the Board proposed to amend § 205.5(c) to provide that written notice of loss or theft of an access device or possible unauthorized transfers is effective when the consumer deposits the notice in the mail or transmits it by any other usual means to the financial institution (44 FR 30690, May 29, 1979).

The Board proposed this "mailbox rule" in order to give interested parties an opportunity to comment on the merits and costs of the proposed change. The Board received 128 comments on the proposal; 14 favored adoption in the form proposed, and the rest of the commenters were either completely opposed or suggested modification of the proposal in some way.

The comments in favor of the proposal stated that the losses which occur during the transmission period of written notice are more easily borne by financial institutions than by individual consumers. These commenters felt that the escalating liability structure of the Act justifies the shift of liability for losses to financial institutions. Other commenters stated that a mailbox rule would encourage the development of more secure EFT systems.

The comments in opposition to the proposal stated that a mailbox rule will result in increased losses to financial institutions, and that such losses would eventually be borne by consumers in the form of increased costs for EFT services. Some commenters felt that the proposed rule would discourage telephone notification and would actively encourage consumer fraud by providing a means by which a consumer who forgot to report or had delayed reporting could avoid the higher liability limit. Under the proposal, it would be possible for a consumer to state that a written notice had been transmitted (thereby cutting off the consumer's liability) when such a notice had been delayed or had not been sent. However, under the present rule, a consumer could avoid the higher limit by stating that the loss or theft of the access device had just been discovered.

Many comments mentioned the unreliability of the postal system as one reason why the proposal should not be adopted. A large number of commenters cited the difficulty of establishing the time at which a consumer posted a written notice to determine the point at which liability would shift from the consumer to the financial institution. Financial institutions stated that they have procedures to identify when mail is received, such as date-stamping incoming correspondence, so that the same proof problem does not exist with the present receipt rule.

Modifications of the proposal were suggested by a number of commenters. The recommended changes included (a) requiring oral notification instead of permitting either written or oral notification, (b) requiring written notification to be sent by registered or certified mail, and (c) permitting institutions that maintain 24-hour, toll-free telephone reporting systems to apply a receipt rule for written notification, while institutions that do not maintain such systems would be bound by a mailbox rule.

The Board had solicited comment on what percentage of notifications of loss, theft or unauthorized use are oral. The estimates supplied by commenters were very high; they ranged from 75 to 100 per cent, with most in the 90 to 95 per cent range. These estimates correspond to the Board's belief that the majority of consumers notify their institutions of loss or theft either in person or by telephone.

(2) *Amendment of § 205.5(c).* The Board has decided to adopt the amendment as proposed. Thus, written notice of loss or theft of an access device or possible unauthorized transfers will be effective at the time the consumer deposits the notice in the mail or otherwise transmits it to the financial institution.

The Board believes that telephone or personal notification of loss or theft is the most desirable method and should be actively encouraged by financial institutions. However, requiring telephone notice would be inconsistent with the statute, which permits written as well as oral notice. As to the other modifications suggested by the commenters, requiring written notification to be sent by registered mail would alleviate the problems of proof that a mailbox rule presents, but would not result in earlier notification and would be an added inconvenience and cost for consumers. The recommendation that institutions providing toll-free access for reporting be permitted to use a receipt rule would be, according to comments, an unwarranted burden on small financial institutions that would find the cost of such systems prohibitive in relation to their losses.

The effect of the mailbox rule will be to shift from the individual consumer to the financial institution (and ultimately to all the institution's customers) the losses over $50 that occur during the period between posting written notice and receipt of such notice. The Board believes this appropriate in light of the liability structure of the Act.

The Board believes that the provision in § 909(a) which states that notice is considered given when "such steps have been taken as may be reasonably required in the ordinary course of business to provide the financial institution with the pertinent information" can be interpreted by the Board under its authority in § 904 of the Act to support the adoption of a mailbox rule.

The Board is of the opinion that the consumer benefit to be gained by the adoption of a mailbox rule will outweigh the effect of shifting liability to financial institutions for losses from unauthorized transfers during the transmission period of a written notice.

(3) *Economic Impact Analysis.* Section 904 (a)(2) of the Act requires the Board to prepare an analysis of the economic impact of the regulation issued by the Board to implement the Act. The following economic analysis accompanies revised § 205.5(c), which implements, in part, § 909 of the Act.[1]

The regulation is to be amended so that written notice of loss or theft of an access device or possible unauthorized electronic fund transfers shall be considered given when transmitted by a consumer to a financial institution. Both costs and benefits are associated with this change. Those consumers who elect to give written notice, either because of personal preference or because other means are unavailable to them, will be protected from liability for any unauthorized transfers made after notice has been transmitted. This ensures uniform application of the Act's two-day $50 liability limit protection to consumers regardless of how notice is given and constitutes a benefit to consumers.

Public comments offered no empirical evidence demonstrating a need for a change in the existing rule, which considers notice to be given when received by the financial institution. However, a consumer using the mails to transmit written notice would be likely to fall into the $500 liability limit category before the notice was received by the financial institution, and losses due to fraud would be expected to increase while the notice was in the mail, so that choosing to give written notice could expose a consumer to substantial liability under the existing rule.

Besides uniformity of treatment with respect to the Act's notice deadlines, consumers will benefit from the amendment in two additional ways. First, loss exposure will no longer depend on the speed or accuracy of mail delivery, factors largely out of a consumer's control. Second, loss exposure will not be affected by a consumer's inability to notify a financial institution by telephone. Other factors held equal, the revised rule can be expected to reduce aggregate losses by consumers. It will also reduce the likelihood of "catastrophic" individual losses that might have occurred under the receipt rule if a low-wealth, low-income consumer chose to give written notice and became subject to the $500 liability limit because of the financial institution's not having received the notice within 2 days. In making the $50 liability limit more widely applicable, the amendment makes EFT cards more like credit cards, a result that may promote consumer acceptance of EFT cards as a payments mechanism and lead to greater efficiency in the payments system as a whole.

For financial institutions, the amendment means that loss exposure will depend on how many consumers elect to give written notice by mail, the consumer's choice of mailing location, and the speed and accuracy of mail delivery, factors an institution cannot control. To the extent that the amendment removes some incentive for prompt reporting of loss, theft or suspected unauthorized use, total EFT fraud losses can be expected to increase. Consumers choosing written notice will have more time to transmit notice without losing the protection of the liability limit. Many commenters pointed out that fraudulent transfers are most likely to occur in the two-day period immediately following loss or theft of an access device, so that, if the amendment leads to relatively fewer prompt notifications by telephone, financial institutions will suffer greater losses before notices are received and access to affected accounts can be blocked. Furthermore, litigation costs would be increased by the difficulty of proving when a notice was mailed.

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[1] The analysis must consider the costs and benefits of the proposed regulation to suppliers and users of EFT services, the effects of the proposed regulation on competition in the provision of electronic fund transfer services among large and small financial institutions, and the effects of the proposed regulation on the availability of EFT services to different classes of consumers, particularly low-income consumers. The analysis presented here is to be read in conjunction with the economic impact analysis that accompanied the Board's Regulation E at 44 FR 18474, March 28, 1979.

The amendment, in providing an additional consumer protection, might remove some incentive for prompt reporting of loss, theft, or suspected unauthorized use. The costs of related fraud losses to financial institutions and the payments system will be passed on to consumers in some degree through higher EFT prices or reduced levels of EFT services. Additional costs resulting from the amendment are expected to be small relative to the volume of EFT transactions. The long-run effect of the amendment on the evolution of EFT and the payments system cannot be predicted, however, and will merit future study.

Text of Amendment

(4) Pursuant to the authority granted in Pub. L. 95-630 (to be codified in 15 U.S.C. 1693b), the Board amends paragraph (c) of 12 CFR § 205.5 (Regulation E), by deleting the third sentence and substituting the following sentence, to read as follows:

SECTION 205.5 — LIABILITY OF CONSUMER FOR UNAUTHORIZED TRANSFERS

* * *

(c) * * * **Notice in writing is considered given at the time the consumer deposits the notice in the mail or delivers the notice for transmission by any other usual means to the financial institution. * * ***