

SCHWARTZ & BALLEN LLP
1990 M STREET, N.W. • SUITE 500
WASHINGTON, DC 20036-3465

(202) 776-0700

FACSIMILE
(202) 776-0720

www.schwartzandballen.com

M E M O R A N D U M

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To Our Clients and Friends

Re: Federal Reserve Proposed Rule on Electronic Fund Transfers

The Federal Reserve Board (the “Board”) is requesting comment on proposed amendments to Regulation E, Electronic Fund Transfers, to provide guidance to parties engaged in electronic check conversion transactions. In addition, the Board proposes to treat payroll card accounts as “accounts” covered by Regulation E. The proposal also provides guidance relating to several additional matters. Comments on the proposed amendments are due November 19, 2004.

ELECTRONIC CHECK CONVERSION

Transactions originated by check, draft, or similar paper instrument are generally not covered by the Electronic Fund Transfer Act (the “Act”) and Regulation E. However, the Official Staff Commentary to Regulation E provides that the conversion of a check into a one-time electronic fund transfer (“EFT”) from the consumer’s account will be subject to the Act and Regulation E if the consumer authorizes the transaction as an EFT. This authorization may occur if the consumer is informed that the transaction will be processed as an EFT and the consumer completes the transaction.

The Board is proposing to incorporate staff guidance on electronic check conversion into Regulation E. Under the proposed revisions to Regulation E, merchants and other payees will be required under the Regulation to obtain the consumer’s authorization for the EFT arising from an electronic check conversion. The proposal would also clarify that the merchant payee must provide the notice to the consumer for each electronic check conversion transaction. However, the notice could be a generic statement posted on a sign, or a written statement provided at the point of sale or with a billing statement or invoice.

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A person initiating an EFT using information from the consumer's check would also be required under the proposal to notify the consumer that the funds may be debited from the account quickly and, if applicable, that the consumer's check will not be returned by the consumer's financial institution. The proposal contains model clauses that merchants and other payees can use to provide these notices to consumers.

Under the proposal, a merchant or payee may obtain a consumer's authorization that permits either electronic check conversion to an EFT or processing the check as a check transaction.

PAYROLL CARDS

Under the Board's proposal, an account into which employee salaries are deposited on a recurring basis would be subject to Regulation E if the funds in the account may be accessed electronically by a payroll card issued to the employee. The account would be subject to Regulation E regardless of whether the account is operated or managed by the employer, a third-party payroll processor or a depository institution.

PREAUTHORIZED TRANSFERS

Regulation E requires that recurring electronic debits from a consumer's account be authorized only by a writing signed or similarly authenticated by the consumer. Currently, the Official Staff Commentary provides that a tape recording of a telephone conversation with a consumer who agrees to preauthorized debits does not constitute written authorization. The Board proposes to withdraw this guidance.

In addition, the Official Staff Commentary would clarify that a merchant who asks a consumer by telephone or on-line to specify whether a card used for authorizing recurring charges is a debit or credit card will not be in violation of the requirement that debit card authorizations must be in writing if the consumer indicates that the card is a credit card when, in fact, it is a debit card.

OTHER MATTERS

The proposal also makes minor revisions to the Official Staff Commentary to clarify when a financial institution may issue supplemental access devices, to provide additional guidance regarding a financial institution's obligation to investigate certain types of alleged errors, and to clarify certain disclosures at ATMs.

The proposed rule can be found at http://www.schwartzandballen.com/whats_new.html. If you have any questions, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.