

Payment Law Update

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Objective

- Review some of the latest payment laws and regulations impacting financial institutions
 - This year the focus is on proposed rules
 - Regulation CC
 - Regulation E (remittances)
- Payment Law Update “Rapid Fire”
 - Dodd-Frank Act (DFA) payment related provisions
 - Regulation E and certain overdrafts
 - Corporate account takeovers
 - Data security
- Question and Answers

Proposed Amendments to Regulation CC

- March 2011 – Proposed rule to facilitate the banking industry’s ongoing transition to fully-electronic interbank check collection
 - The full benefits and cost savings of the electronic methods, however, cannot be realized so long as some banks continue to employ paper-processing methods
- Comment period closed on June 3, 2011
- 70+ comments posted on Board’s website available at:
http://www.federalreserve.gov/generalinfo/foia/index.cfm?doc_id=R%2D1409&doc_ver=1&ShowAll=Yes
- Proposed rule is available at:
<http://www.federalreserve.gov/newsevents/press/bcreg/20110303a.htm>

Move to Electronics

Date	Number of checks deposited electronically with the Federal Reserve Banks	Number of checks the Federal Reserve Banks presented electronically
Year-end 2005	4%	28%
12/2010	99.7%	98.4%

Date	Returned Checks
Year-end 2005	Virtually all paper
12/2010	Reserve Banks received 97.1% of returned checks electronically Reserve Banks delivered 76.7% of returned checks to depositary banks electronically

Proposed Amendments to Regulation CC (continued)

- Condition a depository bank's right of expeditious return on the depository bank agreeing to accept returned checks electronically either directly or indirectly through the paying bank
- Proposes to delete the notice of nonpayment provision as unnecessary
- Proposes to modify the same-day settlement rule
- New proposed warranties related to electronic items not derived from checks

Proposed Amendments to Regulation CC (continued)

- “Refer to Maker”
- Clean up Regulation CC – no nonlocal checks
- Revise model forms
- Update preemption determination
- Potential future changes to reduce risks to depository banks – reduce the amount of time afforded to the paying bank to decide whether or not to pay a check that has been presented to it

Remittance Transfers

- Section 1073 of DFA added a new Section 919 to the Electronic Fund Transfer Act regarding Remittance Transfers (15 USC §1693o-1)
- Board of Governors issued a proposed rule for remittance transfers
 - Comments due by July 20, 2011
 - Available at: <http://www.federalreserve.gov/newsevents/press/bcreg/20110512a.htm>
- Final rules must be prescribed not later than 18 months after DFA enactment = January 21, 2012
 - As a result, while the Board issued the Proposed Rule, Final Rules will be issued by the Bureau of Consumer Financial Protection
- Other changes
 - Automated Clearing House—Board to work with Reserve Banks and the Treasury to expand the use of the ACH system and other payment mechanisms for remittance transfers to foreign countries. This will also require an annual report to Congress from the Board on the status of the ACH system and its progress in comply with this obligation
 - Expansion of Financial Institution Provision of Remittance Transfers—Federal Banking Agencies and NCUA are to provide guidelines to their regulated entities regarding the offering of low-cost remittance transfers and no-cost or low-cost basic consumer accounts

Remittance Transfers



- What it is
 - The *electronic* transfer of funds requested by a sender to a designated recipient that is sent by a *remittance transfer provider* (“RTP”) (Proposed 12 CFR § 205.30(d))
 - Sender must be a consumer
- What it is not
 - Must be electronic
 - There must be a RTP--merely depositing funds into a checking account to which you have access does not count (Proposed comment 30(d)-(1))
 - Small Value exclusion = \$15

Disclosures Required

- Pre-Payment Disclosure
 - Amount to be transferred, fees and taxes imposed by RTP, total amount of transaction in the currency in which the funds will be transferred, exchange rates used, other fees and taxes imposed by third parties, amount to be received
- Receipt
 - Information from pre-payment disclosure, date funds will be available to recipient, name of recipient, error resolution rights, contact information of RTP, contact information of applicable state regulator as well as the Consumer Financial Protection Bureau who to contact with complaints
- Combined Disclosure of the pre-payment disclosure and the receipt is permissible but must be given *prior to payment*

Requirements relating to disclosures

- Must be written or electronic
 - Unless you can invoke the exemptions to satisfy the disclosure requirement over the telephone
- Must be in English and other foreign languages principally used at that location (will not be the same across offices)
- Clear and conspicuously describe the information
 - Means readily understandable and location and type size are readily noticeable to senders
- Must comply with ESIGN if electronic
 - Only exception is if remittance transfer is requested electronically, then pre-payment disclosure can be sent without complying with consumer consent and other ESIGN provisions
- Must be retainable
- Other specific format requirements, model forms provided in Appendix A



Remittance Transfer Errors



- Errors
 - An incorrect amount paid by a sender in connection with a remittance transfer
 - A computational or bookkeeping errors made by the RTP relating to a remittance transfer
 - The failure to make available to a designated recipient the amount of currency stated in the disclosure (unless an estimate was used)
 - The failure to make funds available to the designated recipient available on the stated date of availability (some exceptions)
 - The sender's request for required disclosure documentation
- Not an Error
 - Transfer involving \$15 or less
 - Inquiry into the status of a transfer
 - A request for information made for tax or other recordkeeping purposes
- Notice of Error to RTP from sender must be made within 180 days of the stated funds availability date
 - 60 days if based upon a request for documentation or clarification
- Remittance Transfer Provider has 90 days to respond
 - Must provide sender a report of findings within three business days

Remittance Transfer Errors

- Remedies--Must be made within one business day
 - Refund to sender
 - Provide funds to recipient
 - Must also refund fees paid by sender by any party
 - Other approved remedies
 - Provide notice detailing why no error occurred
- These are in addition to other rights the consumer may have under federal law (§205.33(f))
 - The sender could provide a Notice of Error to the RTP as well as to the account-holding institution if an EFT was involved (§205.11)
- Record-keeping
 - Obligations outlined in §205.33(g)(1)—must develop a compliance program and retain error-related documentation

Cancellations and Refund of Remittance Transfers

– Cancellation and Refund

- Must cancel the transfer if RTP receives an oral or written request to cancel within one business day of when the sender makes payment. RTP could offer a longer period.
 - Sender must provide RTP enough information to be able to identify the remittance
 - Funds cannot have been picked up by recipient yet

– Refund

- Must refund amount of remittance and any fees of cancelled remittance within three business days
 - Fees include fees imposed by the RTP *or any other third party in the process*
- Can be in cash or in the same manner in which the remittance was paid for

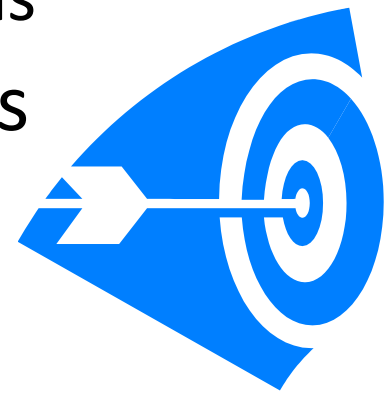
Uniform Commercial Code Article 4A-108

- UCC Article 4A primarily governs the rights and responsibilities among commercial parties to a wire transfer including the parties' payment obligations and allocation of risk of loss for unauthorized or improperly executed payment orders
 - UCC 4A-108 states that it does not apply to “a funds transfer any part of which is governed by the Electronic Fund Transfer Act”
 - DFA's Section 919 now makes wire transfers that qualify as a remittance transfer sent on a consumer's behalf as subject to EFTA
- Thus, Article 4A may no longer apply to such consumer wire transfers that are found to be remittance transfers
- The Board believes the authority for resolving the uncertainty rests with the states or through the rules applicable to the relevant wire systems

Payment Law Update

“Rapid Fire”

- Dodd-Frank Act payment provisions
 - Expedited Funds Availability Act
 - Impact of Bureau of Consumer Protection and Financial Stability Oversight Council
 - Interest-bearing transaction accounts authorized
 - Other payment law related provisions
- Regulation E and certain overdrafts
- Data Security
- Corporate Account Takeovers



DFA Amendments to Expedited Funds Availability Act

- Section 1086 of the DFA amends the Expedited Funds Availability Act by increasing from \$100 to \$200 the amount of deposited funds that banks must make available for withdrawal by opening of business the next day



- **Effective Date: July 21, 2011**
 - Statutory - applies even if Regulation CC amendments are not made

Other DFA Amendments that impact Expedited Funds Availability

- Section 1086 of the DFA also amends the Expedited Funds Availability Act to require the Board, jointly with the Bureau of Consumer Financial Protection to update the dollar amounts to reflect inflation every five years after December 31, 2011
- Certain rule-writing will be joint between the Board and the Bureau on the transfer date

Impact of Bureau and FSOC?

- Section 1011 of the DFA establishes the Bureau of Consumer Financial Protection
 - Transfer of consumer financial protection functions
- Section 111 of DFA establishes the Financial Stability Oversight Council
 - Duties include identifying systemically important financial market utilities and payment, clearing, and settlement activities

Interest-bearing transaction accounts authorized

- Section 627 – Interest-bearing transaction accounts authorized
 - Repeals Section 19(i) of the Federal Reserve Act which is the statutory prohibition against payment of interest on demand deposits by institutions that are member banks of the Federal Reserve System
 - Board issued a Notice of proposed rulemaking and request for comment in April, 2011
 - Comment period expired May 16, 2011
 - Proposed rule seeks to repeal Regulation Q and provide for conforming technical amendments in Regulation D and the staff commentary to Regulation DD
 - Available at: <http://www.federalreserve.gov/newsevents/press/bcreg/20110406a.htm>
- Effective date of Section 627 is July 21, 2011

Other DFA Payment Related Provisions

- Section 1075 - Reasonable fees and rules for payment card transactions
 - Interchange
 - Noted in slide deck due to relevancy
 - Not for discussion today
 - Limitation on restrictions on offering **discounts** for use of a form of payment
 - Limitation on restrictions on setting transaction minimums or maximums

Regulation E Update - Overdrafts

- November 2009 – final rule amending Regulation E and the commentary
 - Limits the ability of a financial institution to assess an overdraft fee for paying automated transfer machine (ATM) and one-time debit card transactions that overdraw a consumer's account unless a consumer affirmatively consents, or opts in, to the institution's payment of overdrafts for those transactions
 - May 2010 – Clarifications to November final rule
- FDIC guidance available at:
<http://www.fdic.gov/news/news/financial/2010/fil10081.html>
<http://www.fdic.gov/news/conferences/overdraft/FAQ.html>
- OCC guidance available at:
<http://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-23a.pdf>

Payments Fraud

2011 Business Banking Trust Study - authored by Guardian Analytics with the Ponemon Institute

- 56 percent of respondent businesses experienced fraud in the last 12 months
- 75 percent of the respondent businesses experienced online account takeover and/or online fraud
- Banks took losses in 37 percent of cases by reimbursing businesses for unrecovered funds, and businesses took losses in 60 percent of cases

Available at:

<http://info.guardiananalytics.com/2011TrustStudyKit.html>

DIs liable for Cyber Crimes?

Corporate Account Takeovers



- If a corporate customer/member's account is hacked and/or account information is otherwise compromised and funds are lost--who is responsible?
- Several corporate customers have sued their DIs alleging the DI is responsible for not protecting the customer's funds from theft (e.g. negligence, breach of contract, breach of fiduciary duty)
- Other corporate customers argue that there is a common law duty to protect customer's confidential information from identity theft
- Many ACH cases are focusing on whether the security procedures in place were "commercially reasonable" UCC §4A-202

Commercially Reasonable

What some plaintiffs have argued is required for their situation:

- Multifactor authentication (FFIEC’s 2005 “Authentication in an Internet Banking Environment”)
- Block of unknown IP addresses
- Red flagging atypical payments
- ACH transfer limits
- Notify via other means (e.g. phone call)

Case Law

- PATCO CONSTRUCTION CO. v. PEOPLE'S UNITED BANK d/b/a OCEAN BANK
 - PATCO has its account taken over through malware hijacking the online banking log on and password for PATCO'S commercial account with Ocean Bank
 - Loss of \$345,444.33 (\$230,000 was recovered)
 - PATCO sued Ocean Bank for failing to detect or prevent the transactions arguing that the security measures were not commercially reasonable
 - *May 27, 2011*—magistrate judge recommends District Court of Maine to grant Ocean Bank's motion for summary judgment on the commercial reasonableness issue. PATCO requesting oral argument on the decision
- EXPERI-METAL, INC. v. COMERICA BANK
 - EMI's employee fell victim to phishing scam which revealed EMI's user ID, PIN and account information to its corporate account at Comerica
 - Over \$1.9 million wired out of the account in 97 transactions, \$560,000 not recovered
 - At issue was whether Comerica complied with its security procedure and whether Comerica acted in good faith
 - *June 13, 2011*--Bench Opinion found that Comerica did comply with its security procedure (employee was authorized to initiate wire transfers), but that Comerica did not sufficiently prove that they acted in good faith

Regulatory & Legislative Developments

- The FFIEC regulators, lead by the FDIC, are working on an update to the 2005 Guidance on Authentication document
- Multiple bills pending at the federal level trying to address Cyber Security and data privacy
 - Senator Leahy’s bill, S. 1151, “To prevent and mitigate identity theft, to ensure privacy, to provide notice of security breaches, and to enhance criminal penalties, law enforcement assistance and other protections against security breaches, fraudulent access, and misuse of personally identifiable information,” June 7, 2011
 - Rep. Stearns, H.R. 1841, “Data Accountability and Trust Act of 2011,” May 11, 2011

Question and Answer Session

