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Robert G. Ballen

Thomas A. Fox

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THE ROLE OF PRIVATE SECTOR PAYMENT RULES AND A PROPOSED APPROACH FOR EVALUATING FUTURE CHANGES TO PAYMENTS LAW

ROBERT G. BALLEEN AND THOMAS A. FOX*

INTRODUCTION

This article considers the role of private sector payment organizations in establishing payment transaction rules among and between their participating financial institutions. The article posits that private sector payment organizations should continue to play the primary role in establishing rights and responsibilities for payment transactions between their participating financial institutions, provided that their rules are consistent with customer protections established by federal and state governmental authorities for the customer-financial institution relationship. This article also discusses the difficulty in establishing new payment statutes at both the state and federal level, and the successes of private sector payment rules over the last twenty years in facilitating the development of new payment products. In light of that experience, the article sets forth a paradigm for evaluating future substantive changes to federal or state payments statutes, such as a proposal to unify payment laws across payment product types.

It is the authors' view that the current payments law structure, relying on a combination of private sector rules, baseline statutory consumer protections, and (in the case of check payments) a somewhat variable uniform check collection statute,¹ has shown remarkable flexibility in facilitating and responding to the unprecedented scope and pace of change that has occurred in the retail payments world over the last twenty years. These changes to the nature and type of payments have been dramatic, and include notably the successful development and implementation of check image exchange, check-to-EFT conversion programs, new Internet-based payment methods, signature and PIN debit cards, and prepaid/stored value

* Messrs. Ballen and Fox are partners in the Washington D.C. law firm of Schwartz & Ballen LLP, a financial services law firm specializing in payments law and other financial services law and regulatory matters. This article is based upon their presentation at the Rethinking Payments Law Symposium held at the Federal Reserve Bank of New York on April 27, 2007.

1. U.C.C. art. 4 (2005).

cards. These new payment types and processes have been enabled and supported by the ability of U.S. financial institutions to establish the rights and responsibilities of the financial institutions with regard to these new payment transactions, or modify rights and obligations imposed under law, through private sector payment rules.

The ability of financial institutions to establish or modify consumer protection rights (as distinct from the interbank rules) is more limited. Federal and state laws and regulations establish certain baseline consumer and business protections that are either not variable by the financial institutions, or are variable only to a limited extent as permitted by law. The federal regulators have adopted revisions to these customer protection rules over the last decade to address certain new payment products; however, with the exception of certain limited changes to Regulation CC² for check collection, these regulations do not address interbank obligations or processes.

For the reasons discussed in this article, the financial services industry should continue to support these two separate spheres of payment laws, namely private sector rules and government-mandated baseline consumer protection rules. The payment system stakeholders should not attempt to further regulate or limit, either by legislation or by regulation, the ability of the interbank payment system to establish private sector rules governing the relationships between their participating financial institutions.

I. OVERVIEW OF SCOPE AND APPLICATION OF PAYMENT LAWS

The primary federal laws in the consumer payments area are the Electronic Fund Transfer Act (EFTA)³ and Regulation E⁴ (for debit cards, Automated Clearing House (ACH) transfers, prepaid payroll cards, and other consumer electronic funds transfers); the Truth in Lending Act (TILA)⁵ and Regulation Z⁶ (for credit card payments, including online services that use credit cards); and the Expedited Funds Availability Act (EFAA)⁷ and Regulation CC⁸ (for check payment processing, substitute

2. Collection of Checks and Other Items by Federal Reserve Banks, 70 Fed. Reg. 71,218, 71,225–26 (Nov. 28, 2005) (to be codified at 12 C.F.R. pt. 229) (addressing transfer and presentment warranties for remotely created checks (RCC)); Availability of Funds and Collection of Checks, 69 Fed. Reg. 47,290 (Aug. 4, 2004) (to be codified at 12 C.F.R. pt. 229) (addressing substitute checks and implementing the Check 21 Act).

3. 15 U.S.C. §§ 1693–1693r (2000).

4. 12 C.F.R. pt. 205 (2007).

5. 15 U.S.C. §§ 1601–1667(f) (2000).

6. 12 C.F.R. pt. 226 (2007).

7. 12 U.S.C. §§ 4001–4010(f) (2000).

8. 12 C.F.R. pt. 229 (2007).

checks, and funds availability). Using these three statutes and corresponding regulations, the Federal Reserve Board establishes the fundamental rights and protections for consumers when initiating or receiving payments. These laws are not (with the exception of Regulation CC to a certain extent)⁹ variable by the agreement of banks and their customers, although banks can provide their customers with protections that go beyond the requirements of these regulations.¹⁰

A number of states have state law equivalents of the EFTA and TILA.¹¹ In addition, at the state level, the Uniform Commercial Code (U.C.C.) Articles 3 and 4 establish the payment rules for checks for both interbank collection and the relationship between a bank, its depositing customer, and its check drawer customer. Unlike the federal payments laws, Article 4 of the U.C.C. governing check collection may be varied by agreement of the parties (such as in a deposit account agreement) or by clearinghouse rule.¹² Many financial institutions vary provisions of the U.C.C. under Article 4 with respect to their customer relationships, such as the time period for a drawer customer to review a statement for erroneous check entries¹³ and a depositing customer's liability for warranty claims made on a check that has been previously paid. The ability to vary the U.C.C. by agreement or clearinghouse rule is not unlimited. For example, the U.C.C. obligation to act in good faith cannot be waived by agreement of banks and their customers.¹⁴

However, with the exception of the Regulation CC requirements for check processing, the Federal Reserve Board consumer payments regulations and the related federal statutes do not generally address the interbank payment systems and the liabilities that flow into the interbank system from a financial institution that provides its consumers with the statutorily-mandated protections. For example, for unauthorized payments, both Regulation Z (for credit cards) and Regulation E (for debit cards and EFTs) establish significant protections in favor of the consumer for liability for

9. In § 229.37 of Regulation CC, banks are permitted to modify by agreement certain requirements of Regulation CC relating to collection of items among banks. By comparison, banks cannot alter by agreement with their customers the requirements of Regulation CC relating to availability of funds or the creation and collection of substitute checks. 12 C.F.R. § 229.60.

10. 15 U.S.C. § 1693i; 12 C.F.R. § 226.12(b)(4).

11. See, for example, the Illinois Electronic Fund Transfer Act, 205 ILL. COMP. STAT. ANN. 616/1 (West 2007), and the Massachusetts Electronic Branches and Electronic Fund Transfers Act, MASS. GEN. LAWS ANN. ch. 167B (West 2003 & Supp. 2008).

12. U.C.C. § 4-103 (2005).

13. *Id.* § 4-406(f) (providing a customer one year to review a check statement).

14. *Id.* § 4-103(a).

unauthorized or erroneous payments.¹⁵ These same regulations do not address the extent to which the consumer's financial institution may allocate its liability for that same unauthorized payment back to other participants in the payment system. As a result, the private sector payment system rules governing credit cards and electronic funds transfers have developed a detailed system of allocating among the financial institution payment participants the losses associated with fraud and unauthorized transactions; this allocation depends on factors such as whether a prior authorization was provided for the transaction, when the unauthorized transaction claim was entered into the system, and the type of merchant (such as telemarketers or online merchants) involved in the transaction.¹⁶ These different rules allow the various payment systems to encourage fraud reduction or other policies deemed important by their participants by allocating losses to appropriate financial institution participants.

II. STRUCTURE OF PRIVATE SECTOR PAYMENT RULES

The structure and scope of private sector payment system rules vary across payment product types. For credit, debit and prepaid cards, and other card association/network-branded transactions, the card associations and card networks¹⁷ establish rules that govern the card issuer and card transaction acquirer relationships in authorizing, clearing, and settling the payment. The card association rules¹⁸ include extensive requirements on member financial institutions to establish baseline requirements for their customer relationships, such as extended consumer protections to be provided to their card customers. For example, the Visa and MasterCard rules have established limitations on cardholder liability for certain card transactions that provide superior protection against loss to the cardholder com-

15. Regulation E limits a consumer loss for an unauthorized electronic funds transfer to no greater than \$50 in the event the loss arises from a lost access device and the customer notifies the financial institution within two days. The consumer's exposures for other types of unauthorized electronic funds transfers depends on the time period in which the consumer notifies the financial institution after receipt of a periodic statement that reflects the unauthorized transfer. 12 C.F.R. § 205.6. For credit cards, a consumer's exposure to potential loss is limited to \$50. 12 C.F.R. § 226.12(b)(1).

16. See, e.g., MASTERCARD, NOVEMBER 2007 CHARGEBACK GUIDE (2007), http://www.mastercard.com/us/wce/PDF/Chargeback_Guide_Nov_2007_no_contact_info.pdf.

17. The largest card associations are Visa Inc. and MasterCard Inc., which have both issuing card member banks and merchant acquiring member banks. These card associations use operating rules to establish the rights of the issuing and acquiring banks (as well as the network) to the payment transaction. In some other networks, such as American Express and Discover, the card issuing entity also serves as the card acquiring entity for the merchants.

18. The card associations and other payment networks have generally not made their entire rules sets available to the general public. However, card associations and networks provide a summary of those rules and system requirements that are applicable directly or indirectly to merchants. See *infra* notes 21, 28, 34.

pared to Regulation Z or Regulation E in the event a lost or stolen credit or debit card is used fraudulently. The member financial institutions are required to provide this level of protection to their cardholder customers. Similarly, these card associations have imposed receipt and transaction disclosure requirements on their member financial institutions that go beyond the basic requirements in Regulations Z and E.

For check transactions generally, and image exchange in particular, banks use clearinghouse rules (most notably the Electronic Check Clearing House Organization Rules¹⁹ in the case of a check image) to modify and supplement their rights and responsibilities under the Uniform Commercial Code and Regulation CC of the Federal Reserve. Check clearinghouse rules are recognized under Article 4 of the Uniform Commercial Code as an agreement that can alter the rights of any person interested in the items that are collected through the clearing house.²⁰ Unlike card association rules, check clearinghouse rules typically do not impose many baseline requirements on a financial institution's relationship with its consumer and business customers. The bank-customer relationship (for both depositing and paying customers) is left to applicable U.C.C. and Regulation CC provisions and the financial institution's account agreement.

For electronic funds transfers processed through the ACH system, the banks rely on the Operating Rules of the National Automated Clearing House Association (NACHA).²¹ For those banks that send and receive ACH transactions through the Federal Reserve, the Federal Reserve incorporates by reference the NACHA Rules.²² The NACHA Rules establish requirements governing transaction formats, authorization requirements, recordkeeping, and warranties and indemnifications for the banks participating in the ACH.²³ The NACHA Rules do not apply directly to merchants and other non-financial institutions that initiate an ACH transaction or to consumers and businesses whose accounts are debited or credited by ACH transactions.²⁴ However, the NACHA Rules do require financial

19. The Electronic Check Clearing House Organization, Home Page, <http://www.ECCHO.org> (last visited Mar. 11, 2008).

20. U.C.C. § 4-103(b).

21. The NACHA Rules are available for purchase through the NACHA website at <http://www.NACHA.org>.

22. Fed. Reserve Bank, Operating Circular No. 4: Automated Clearing House Items § 1.4, at OR 1 (Mar. 1, 2008), available at http://www.frbservices.org/files/regulations/pdf/operating_circular_4.pdf.

23. NAT'L AUTOMATED CLEARING HOUSE ASS'N, 2007 ACH RULES: A COMPLETE GUIDE TO RULES AND REGULATIONS GOVERNING THE ACH NETWORK § 1.7, at OR 2, § 2.2.1.9, at OR 6, § 2.2, at OR 5 (2007) [hereinafter NACHA RULES] (discussing recordkeeping, transactional information requirements, and warranties of originating depository financial institutions, respectively).

24. *Id.* § 1.1–2, at OR 1 (application to depository financial institutions).

institutions to ensure that their merchant customers meet certain requirements when initiating an ACH entry. For example, in the context of Internet-originated ACH transactions (referred to as WEB Entries), the originating depository financial institution is required to ensure that its merchant customer has a reasonable process in place for verifying the identity of the authorizing consumer prior to initiating the transaction.²⁵ In addition, although not required under the NACHA Rules, as a practical matter most financial institutions require their merchant customers (in the ACH origination contract) that initiate ACH transactions to make the same warranties and indemnities relating to the ACH Entry (such as warranty to authorization and eligibility) that the originating depository financial institution makes to other ACH participants under the NACHA Rules when it submits the transaction to the ACH for processing.

III. SUCCESS OF PAYMENT SYSTEM RULES

The changes to the private sector payment rules over the last twenty years have been substantial in order to enable and support the literally unprecedented pace of development of new payment products, designed to take advantage of new technologies and to meet consumer and business customers' needs. First, let us consider the major revisions to those private sector payment system rules that have been developed during the past twenty years.

A. Debit Cards

Debit cards are payment cards that access a cardholder's deposit account. The deposit account typically is maintained by the card issuer, although recently a debit card product has been offered that utilizes a funding deposit account maintained by a depository institution other than the issuer.²⁶ The interbank rules for debit cards are established by the card association under which brand the card is issued (Visa and MasterCard). The EFTA and Regulation E establish baseline protections for consumer debit cardholders that cannot be waived or reduced by customer agreement,²⁷ but as discussed above these protections are supplemented by the card association rules.

25. *Id.* § 2.11, at OR 13 (requirements for origination of Internet-initiated entries).

26. See Aleksandra Todorova, *Capital One Tests a New Type of Debit Card*, SMARTMONEY, June 13, 2007, <http://www.smartmoney.com/consumer/index.cfm?story=20070613>.

27. 15 U.S.C. § 1693i (2000).

B. Prepaid Cards

Prepaid cards are payment cards that a customer loads (typically with cash) in a fixed amount, and then uses the declining balance to make purchases using the card. Unlike with debit cards, there is no customer traditional deposit account associated with prepaid cards; some cards are single use, other cards are reloadable multiple times. The interbank rules for prepaid cards are established by the card associations or other payment providers under which brand the card is issued. These are principally Visa, MasterCard, American Express, and Discover cards. Some of these network rules impose protections for the consumers by mandating the card-issuing bank to provide certain uniform features and protections to consumers (such as 800 numbers used to obtain transaction information or limitations on liability).²⁸ These types of protections are not required by statute, but are generally driven by the competitive market for these cards and consumer expectations when using branded payment cards. Certain states have attempted to establish certain consumer protections for prepaid cards (e.g., fee and expiration date limitations),²⁹ but these state protections have been determined by the courts to be preempted as to federally-chartered depository institution prepaid card issuers.³⁰ The Federal Reserve Board considered, and ultimately did not finalize, a proposed regulation that would have regulated certain aspects of stored value and prepaid card programs back in 1996.³¹ The Federal Reserve Board did address payroll prepaid cards in 2006, bringing these cards directly under Regulation E and the EFTA effective July 1, 2007.³²

28. The card association rule sets are not generally available. MasterCard and Visa do provide a description of the zero liability programs on their websites. See MasterCard, Zero Liability, <http://www.mastercard.com/us/personal/en/cardholderservices/zeroliability.html> (last visited Mar. 11, 2008); Visa, Zero Liability, http://usa.visa.com/personal/security/visa_security_program/zero_liability.html (last visited Mar. 11, 2008).

29. See, e.g., N.M. STAT. ANN. § 57-12-26 (West 2007) (regulating gift certificates and gift cards); CONN. GEN. STAT. ANN. §§ 42-460, 3-56a(5) (West 2007) (regulating gift certificates and providing a definition of a "gift certificate," respectively).

30. See, e.g., SPGGC, LLC v. Ayotte, 488 F.3d 525, 527 (1st Cir. 2007).

31. Electronic Fund Transfers, 61 Fed. Reg. 19,696, 19,696, 19,704-05 (May 2, 1996).

32. Electronic Fund Transfers, 71 Fed. Reg. 51,437, 51,437-38, 51,449-50 (Aug. 30, 2006) (codified at 12 C.F.R. pt. 205). It should be noted that certain elements of a prepaid card program provided outside of a bank may be subject to state regulation under state money transmitter statutes, which typically regulate risk of insolvency of the licensed entity, as opposed to payment law type issues.

C. Check Image Exchange

Check image exchange is the process by which a paper check is truncated (by a depository bank, a collecting bank, or a customer of the depository bank) into an electronic image of the front and back of the paper check; that check image is transmitted to the paying bank for payment. The 1990 Amendments to Articles 3 and 4 of the Uniform Commercial Code and Regulation CC include provisions that recognized that check image exchange and electronic presentment were in the near future.³³ However, these laws do not establish unique rules for check image exchange. As a result, over the last fifteen years, the financial services industry developed private sector clearinghouse rules, under the clearinghouse authority of the U.C.C., to address unique requirements for check image exchanges. The primary rules organization in this regard is the Electronic Check Clearing House Organization (ECCHO), and the ECCHO Rules are used by ECCHO's member banks, as well as the other clearing houses that have licensed the right to use the ECCHO Rules.³⁴ The ECCHO check image exchange rules govern the interbank exchange of check images and seek to build on the rules for paper checks under Regulation CC and the U.C.C. Indeed, the ECCHO Rules establish for members that check images they exchange under the Rules are subject to the U.C.C. rules to the extent those U.C.C. rules are not varied by the ECCHO Rules.³⁵ As a result of this Rule, the same transfer and presentment warranties³⁶ from presenting banks to paying banks that apply under the U.C.C. for a paper check also apply to a check image. The ECCHO Rules additionally address the unique issues associated with check image exchanges, such as image quality, risks of duplication of check images, items eligible for image exchange, and the like.³⁷ The ECCHO Rules in particular, and check clearinghouse rules in general, do not seek to govern the bank's customer relationship for check and check image programs. In the context of the check image program, the bank's relationship with its customer is governed by its agreement with the

33. The U.C.C. provides that banks may make electronic presentment of items pursuant to an agreement for electronic presentment and the exchange of presentment notices. See U.C.C. § 4-110 (2005); see also *id.* § 4-209 (bank retaining an original paper item pursuant to an agreement for electronic presentment warrants retention and presentment of the item will comply with the agreement).

34. The ECCHO Rules are made available upon request to ECCHO. ECCHO, Rules Access, <http://www.eccho.org> (last visited Mar. 11, 2008) (follow "ECCHO Rules" hyperlink).

35. Electronic Images of checks are considered "items" and "checks" for purposes of the U.C.C. and Regulation CC. ELECTRONIC CHECK CLEARING HOUSE ORG., OPERATING RULES AND COMMENTARY § XIX(F) (2007) [hereinafter ECCHO RULES].

36. U.C.C. §§ 4-207, 4-208.

37. See ECCHO RULES, *supra* note 35, § XIX(L) (warranties regarding usability of check image and no duplication); *id.* at XIX(C) (items eligible for image exchange under the ECCHO Rules).

customer or is subject to the Check 21 Act³⁸ (discussed below) if the bank prints and delivers a substitute check to the customer. However, the ECCHO Rules do provide rules under which the paying bank can make a claim to banks that presented the check image, to the extent the paying bank incurs a loss to its customer for certain problems with the check image, such as poor image quality or image duplication.³⁹

D. Internet Payment Products

The growth of the Internet over the last ten years has led to a migration of credit and debit card and other electronic funds transfer payments to the Internet. While there have not been any new implementing statutes to authorize the use of payments in this new communication channel, the private sector payments system rules have responded in a number of ways. NACHA revised its rules to establish a new Internet payment entry category (the WEB Entry) and imposes unique requirements relating to authorization (allowing electronic authorization as well as requirements for verifying customer identity).⁴⁰ On the credit and debit card side, the card associations adopted unique rules for credit and debit cards used at electronic commerce merchants, including unique rules for authorization and liability for charge backs (that is, returns) that vary from the card-present transactions in physical world stores.⁴¹

E. Check-to-EFT Conversion

A check-to-EFT conversion program involves the conversion of paper checks to electronic funds transfers at the merchant point of sale or a lock-box or other back office processing location. The payment system rules for these products are provided under the NACHA Rules,⁴² and in the case of

38. Check Clearing for the 21st Century Act, 12 U.S.C. §§ 5001–5018(e) (Supp. IV 2004).

39. See ECCHO RULES, *supra* note 35, § XIX(N) (addressing the responsibility of sending bank for liability incurred by receiving bank under Check 21 Act when creating a substitute check from an image).

40. Press Release, Nat'l Automated Clearing House Ass'n, NACHA Approves E-Sign For ACH Debits (June 11, 2001), available at <http://www.nacha.org/news/news/pressreleases/2001/PR061101/pr061101.htm>; Press Release, Nat'l Automated Clearing House Ass'n, NACHA Rules for Secure Internet Payments from Consumer Checking Accounts Become Effective Today (Mar. 16, 2001), available at <http://www.nacha.org/news/news/pressreleases/2001/PR031601/pr031601.htm>.

41. For a general description of requirements on merchants accepting cards over the Internet and other card not present environments, including chargeback issues, see VISA, RULES FOR VISA MERCHANTS: CARD ACCEPTANCE AND CHARGEBACK MANAGEMENT GUIDELINES 39–53 (2007), http://usa.visa.com/download/merchants/rules_for_visa_merchants.pdf.

42. NACHA RULES, *supra* note 23, § 2.12, at OR 13 (“Point-of-Purchase Entries”), § 2.9, at OR 10 (“Accounts Receivable Entries”); see also Press Release, Nat'l Automated Clearing House Ass'n,

point-of-sale conversion, are provided by some of the card associations/networks. The payment system rules establish requirements for authorization of these transactions, recordkeeping requirements, limited eligibility for check conversion, and the like. The Federal Reserve Board did adopt a change to its Regulation E official commentary in 2006 that clarified that the consumer authorized an electronic funds transfer if the consumer provided the merchant with a check after the consumer was provided notice that such action would be viewed as consent to initiate an electronic funds transfer to the consumer's bank account.⁴³ The check itself is not a "check" under check law, but rather is viewed as a source document providing the requisite information to originate the EFT. Regulation E addresses the consumer's right to the disclosure and the requirements for the authority to convert the check.⁴⁴ However, Regulation E does not address the interbank liability for these items, which generally are addressed in the NACHA Rules.

IV. CHANGES TO PAYMENT STATUTES OVER THE LAST TWENTY YEARS

In comparison to the substantial changes to the interbank payment rules over the last twenty years, the legislative changes to the statutory payments laws (and most notably the consumer rights with respect to payments) have been relatively modest during this period. The limited scope of these statutory changes reflects in part a lack of political consensus among consumer advocates, businesses, government regulators, and financial institutions for any significant modification or overhaul of U.S. payments law.

At the state level, the most significant development over the last fifteen years in check payments laws has been the revision to the Uniform Commercial Code to provide additional warranties relating to unsigned remotely created drafts or checks (referred to in the industry as RCCs) on consumer accounts.⁴⁵ These U.C.C. changes have been adopted to date in about nineteen of the states as of 2006.⁴⁶ This new U.C.C. warranty for

NACHA E-Check Rules Become Effective March 15 (Mar. 13, 2002), *available at* <http://www.nacha.org/news/news/pressreleases/2002/PR031302/pr031302.htm>.

43. Electronic Fund Transfers, 71 Fed. Reg. 1638, 1640 (Jan. 10, 2006) (codified at 12 C.F.R. pt. 205).

44. 12 C.F.R. § 205.3(b)(2) (2007).

45. *See* U.C.C. §§ 3-416, 3-417, 4-207, 4-208.

46. In 2006, the Federal Reserve indicated in its adopting release to the amendments to Regulation CC that less than half the states had adopted revisions to U.C.C. to address RCCs. According to the Federal Reserve, these states include Arkansas, California, Colorado, Hawaii, Idaho, Iowa, Maine, Missouri, Minnesota, Nebraska, New Hampshire, North Dakota, Oregon, Tennessee, Texas, Utah, Vermont, West Virginia, and Wisconsin. Collection of Checks and Other Items by Federal Reserve Banks, 70 Fed. Reg. 71,218, 71,219 & n.12 (Nov. 28, 2005).

RCCs was not completely novel, and there was existing consensus as to its substance within the financial services industry. Similar warranties for remotely created checks already existed under certain local paper check clearinghouse rules, but were only applicable to banks that exchanged items through those clearing houses, and also varied to some extent across clearing houses.

The slow pace of state adoption of this U.C.C. amendment and the need for nationwide uniformity led the Federal Reserve Board in 2005 to implement comparable provisions in Regulation CC.⁴⁷ This experience is perhaps instructive to those who advocate a new uniform payment law via state law adoption. There is general industry and consumer group support for these amendments to the U.C.C., and yet there is still not national coverage under the U.C.C. for this matter.

At the federal level, the most significant payments legislation during this time period has been the Check Clearing for the 21st Century Act in 2003 (Check 21 Act)⁴⁸ which established the legal equivalence of paper recreations of imaged checks (so-called “substitute checks”), as well as the rights and responsibilities of parties that create and exchange substitute checks. The Check 21 Act is commonly viewed outside of the payments arena as regulating the larger check imaging process in general. However, the Check 21 Act only establishes the ability of financial institutions to use substitute checks created from check images. Nonetheless, this substitute check process provided the industry and the Federal Reserve Banks with the ability to offer products that complement check image exchange programs by enabling banks to be reached that were not check image enabled.

In the past decade, the Federal Reserve Board has implemented a number of regulatory changes under its existing authority under the TILA, the EFTA, and the EFAA,⁴⁹ in many cases to accommodate or encourage developments in new payment products. The Federal Reserve Board revised its regulations to permit online electronic delivery of customer disclosures, which facilitates Internet payment products by allowing the delivery of required disclosures to consumers online when registering for and using Internet payment products. The Federal Reserve also adopted the above-described interpretive guidance and recent rule changes under Regulation E to support check-to-EFT conversion at the point of sale and lock-

47. *Id.* at 71,219–20.

48. 12 U.S.C. §§ 5001–5018(e) (Supp. IV 2004).

49. *See* 15 U.S.C. §§ 1693–1693r (2000); 15 U.S.C. §§ 1601–1667(f) (2000); 12 U.S.C. §§ 4001–4010(f) (2000).

box.⁵⁰ With respect to prepaid cards, the Federal Reserve Board has not sought to regulate these products under Regulation E over the past ten years, thereby providing time for these products to develop and to identify and fill market needs, including for unbanked segments of society. Recently, the Federal Reserve Board issued amendments to Regulation E to regulate a subclass of prepaid/stored value cards that are used in the payroll area.⁵¹

Both the U.C.C. and Regulation CC revisions to address unauthorized remotely created checks and Check 21 Act to address creation and use of substitute checks were directed at specific narrow goals, and generally reflected a consensus for statutory change across the interested stakeholders—including financial institutions, consumer advocates, businesses, regulators, and processors. Without this consensus on general goals, legislation cannot obtain the momentum for passage; a single dedicated group of stakeholders can effectively hold up the process indefinitely. Complicating the legislative enactment process is the fact that legislators and their staffs do not deal with structural-level changes to payments laws on a regular basis, and therefore are often without independent experience or background for judging a payment law policy dispute between the stakeholders. This makes the legislature reluctant to act in the face of a consensus crisis among the stakeholders. In the early stages of both the U.C.C. revisions for remotely created checks and the Check 21 drafting process, there were efforts by different groups to expand the scope of these legislative proposals. For example, there was consideration during drafting sessions as to whether to include additional consumer protections for all unauthorized checks in the U.C.C. and expand the authority provided in Check 21 to cover all forms of check conversion or check image programs.⁵² In both cases, the supporters of a limited scope of the legislative proposals argued that to move outside of the narrow range of the limited legislative proposal would threaten the ability of the parties to pass any legislation through Congress or achieve enactment in the states.

V. BENEFITS OF PAYMENT SYSTEM RULES RELATIVE TO LEGISLATION

There are several critical benefits to relying on a private sector rules approach to establish interbank payment system rules. Changes can be

50. 12 C.F.R. § 205.3(b)(2).

51. Electronic Fund Transfers, 71 Fed. Reg. at 51,449–50 (Aug. 30, 2006).

52. See, e.g., *The Check Clearing for the 21st Century Act: Hearing Before the H. Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services*, 107th Cong. 25 (2002) (testimony of Gail Hillebrand, Senior Att’y, Consumers Union).

implemented much faster through private sector payment rules from development, pilot stage and final implementation. The main limitation on private sector rules' speed of adoption is obtaining the necessary approval and consents of the payment system's participants to changes in the rules, typically through a combination of the private sector payment system's operating committees and board level approvals. By comparison, however, legislation can take anywhere from one to ten years to draft and pass into law. The Check 21 Act, for example, took at least four years of drafting efforts and congressional consideration—possibly longer if one counts internal consideration at the Federal Reserve before it formally invited industry group and consumer input in July 1999.⁵³ While the Check 21 Act is without a doubt more complicated than a run-of-the-mill change to a private sector payment system rule, it would certainly not be more complicated than any effort to unify through legislation the law governing the various types of payments processes. Indeed, an earlier effort to do just that took several years without a legislative proposal ever being introduced, let alone enacted.⁵⁴

Private sector payment system rules, by their nature, are better positioned to address a payment system that is not static and continues to evolve. As discussed above, the U.S. payment system currently is undergoing unprecedented change, and payments law flexibility is needed to address, as they arise, new payment types and unexpected challenges and developments. Payment system rules can also use pilot rules or amend prior rules to address these changes, which is much easier than addressing changes through the legislative process.

Private sector rules also can provide for more specificity than is possible in a statute. Because of the ability to test rules, and amend rules quickly as necessary over time, it is possible for payment system rules to provide greater specificity as to the operation of the payment system than is possible in legislation. The rules of several of the private sector payments systems comprise hundreds of pages of detail. By comparison, overly detailed legislation would run the risk of quickly becoming outdated or locking the

53. Press Release, Federal Reserve Board, Formation of Payments System Development Committee (July 20, 1999), <http://www.federalreserve.gov/boarddocs/press/general/1999/19990720/default.htm>.

54. In the late 1970s and early 1980s there was an effort to unify the U.S. payment codes. This project was referred to as the Uniform New Payment Code. The new code would have established uniform rules for a range of payment products, including checks, electronic funds transfers, and credit cards. Ultimately, this effort was unsuccessful for a lack of consensus on many issues, including consumer protection rights. For a discussion of issues relating to the Uniform New Payment Code effort, see Gregory E. Maggs, *New Payment Devices and General Principles of Payment Law*, 72 NOTRE DAME L. REV. 753 (1997).

industry into a certain set of rigid requirements for payments that do not reflect financial institution, consumer, and business needs in the marketplace.

Private sector payment systems also have a more ready access to industry experts to develop these detailed interbank rules and procedures. Private sector payment systems typically establish committees and subcommittees comprised of financial institution members and other subject matter experts who do “heavy lifting” on rules review, amendment, and development. Private sector payment system staff attend full time to their system rules. In contrast, although legislators and regulators have processes such as hearings and public comment to solicit input, the legislators and regulators have many other competing responsibilities and priorities.

Finally, unlike the legislative and regulatory arenas, private sector rule organizations have the benefit of a competitive payment system marketplace that drives their product and rules innovation. This competition comes in part at the customer level, from the incentive to increase the attractiveness and usefulness to the customers who have choices as to what payment products they use to make a payment (such as credit or debit card). At the payee customer level, some payment systems permit a payee to select the payment type or channel—items such as checks can be collected through different channels including paper check, ACH conversion, and check image. The rules organizations will seek to write rules that efficiently support the products that their member financial institutions will want to offer to consumers and businesses. This makes the rules organization generally responsive to innovation in the market place and changes in demand for products. Put simply, a payment product whose rules do not keep up with market demands over time will be replaced by alternative, more responsive, payment products.

CONCLUSION

The success of the private sector in establishing rules to support both old and new payment products, and the federal consumer protections regulations in addressing consumer and customer level issues, raises the question of which standard the banking industry, and maybe other payments stakeholders, should use when considering whether to support a proposed legislative effort to unify all payments law. If our past experience is a guide to future payments law changes, it suggests that a legislative effort of this nature should only be undertaken (or will only be successful) when two conditions are met:

1. There is a clear need, goal, or objective in the payments arena for a payment rule that can be reached only through legislation. That is, the issue cannot be addressed by private sector payment system rules and/or changes to existing consumer protection regulations by state/federal regulators; and
2. There is sufficient general, albeit not complete, agreement of the payment system participants (financial institutions, processors, consumer groups, businesses, federal regulators, other payments stakeholders) as to the scope and application of the proposed legislation at the time of the initial undertaking.

It is our view that any legislative effort to unify the current payments laws fails both of these tests. First, as discussed above, it may be possible to achieve many of the goals of a unified payment statute without legislation. As between the financial institutions processing and settling the transactions, the financial institutions can achieve many changes to the payment rules through the private sector rules governing the interbank payment system. For example, among many unified features, the card associations currently provide a single set of interbank liability rules for unauthorized payments for many of their card products, even though the different card product types otherwise are subject to different regulation.⁵⁵ At the consumers-bank relationship level, the Federal Reserve Board could provide more uniformity to consumer payment protections under its regulatory authority for consumer protection statutes, without addressing the interbank system responsibilities.

Second, as indicated by the variety of views expressed in the other articles in this issue of the *Chicago-Kent Law Review*, we believe there is little to no agreement among payment system participants as to the scope and application of this proposed legislation, virtually guaranteeing that any effort; like the last efforts in the 1970s and 1980s, the development and enactment of such legislation would necessarily fail.

For these reasons, we do not support a legislative initiative to attempt to unify into one consistent statute all payment system law across all of the current, emerging, and future payment product types.

55. MasterCard and Visa zero liability rules apply to all cards (credit and debit cards) that bear the card association marks. See MasterCard, *supra* note 28; Visa, *supra* note 28. In contrast, under Regulation E, a holder of a debit card is subject to potentially greater liability in the event of unauthorized use of the card (if the holder fails to report such unauthorized use), compared to a holder of a credit card. Compare 12 C.F.R. § 205.6, with 12 C.F.R. § 226.12(b).

