

Payments System Law – Rationalizing Laws and Regs

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Together we'll go far



Agenda

- The Payments Law Patchwork
- Drilling Down – Intermediary Risk

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A Snapshot Of The Payments Law Patchwork

Key laws, regs and rules affecting the processing of payments and the distribution or rights and responsibilities

- ♦ **Federal**

- Electronic Funds Transfer Act
- Expedited Funds Availability Act
- “Check 21” Check Truncation Act
- Regulation E
- Regulation J
- Regulation CC

- ♦ **State**

- UCC Article 3
- UCC Article 4
- UCC Article 4A
- UCC Article 9
- Money transmitter statutes
- Escheat statutes

- ♦ **Private**

- NACHA Rules
- ECCHO Rules

Payment Options (and their dopplegangers)

- ♦ **Check (substitute check) (ACH conversion)**
- ♦ **Demand draft (substitute check)**
- ♦ **Draft**
- ♦ **“Alternate check” (substitute check)(ACH conversion)**
- ♦ **Credit ACH – single or recurring**
- ♦ **Debit ACH – single or recurring**
- ♦ **Reg. E access devices**
 - Debit Card
 - ATM Card
 - Uncoupled debit card
 - Obopay/cellphone
 - Payroll cards
 - EBT cards
- ♦ **General Purpose Reloadable Cards**
- ♦ **Wire transfer**

A Snapshot Of The Payments Law Patchwork – Using Paper Checks as an Illustration*

<i>Parties to Transaction</i>	<i>Applicable Law TRADITIONAL PAPER CHECK</i>	<i>Applicable Law – ACH CHECK CONVERSION</i>	<i>Applicable Law – CHECK IMAGE EXCHANGE</i>
<i>Payee and Payor</i>	State Sales Law Generally UCC 3 Contract	State Sales Law Generally If Consumer transaction, Regulation E – authorization requirement only NACHA Rules impose some minimum standards on merchant authorization from customer.	State Sales Law Generally UCC 3 Check 21 (maybe; if substitute check is imaged or if substitute check is returned in an NSF situation, for example)
<i>Payee and Payee's Bank (ODFI/BOFD)</i>	Customer Agreement UCC 3 and 4 EFAA/Regulation CC	Customer Agreement NACHA Rules impose minimum standard requirements on customer agreements. But rules do not apply directly to customer.	Customer Agreement (may reference UCC/check law) UCC 4 EFAA/Regulation CC Check 21 may apply if a substitute check is involved (For RDC where image is sent from customer to bank, may also seek to apply EFAA subpart B by agreement)

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A Snapshot Of The Payments Law Patchwork – Using Paper Checks as an Illustration*

<i>Parties to Transaction</i>	<i>Applicable Law— TRADITIONAL PAPER CHECK</i>	<i>Applicable Law – ACH CHECK CONVERSION</i>	<i>Applicable Law – CHECK IMAGE EXCHANGE</i>
<i>Payee's Bank To Intermediary Bank</i>	<p>UCC 3 and 4</p> <p>EFAA/Regulation CC</p> <p>Paper Clearing House Rules</p> <p>Federal Reserve Circular and Regulation J (only if FRB exchange)</p> <p>Contract</p>	<p>N/A No intermediary bank in ACH processing.</p> <p>There is an ACH Operator, Operator not a party to payment.</p> <p>But Operator has rights governed by NACHA Rules.</p> <p>If over EPN, EPN rules If over FedACH, Reserve Bank Operating Circulars</p>	<p>ECCHO Rules (if private sector exchange by ECCHO members)</p> <p>Private/correspondent exchange agreements (non-ECCHO members that exchange outside of Fed exchange).</p> <p>Federal Reserve Circular and Regulation J (only if FRB exchange)</p> <p>UCC 4</p> <p>EFAA/Reg CC</p> <p>Check 21/Regulation CC if substitute check is involved at all</p>

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A Snapshot Of The Payments Law Patchwork – Using Paper Checks as an Illustration*

<i>Parties to Transaction</i>	<i>Applicable Law— TRADITIONAL PAPER CHECK</i>	<i>Applicable Law – ACH CHECK CONVERSION</i>	<i>Applicable Law – CHECK IMAGE EXCHANGE</i>
<i>Intermediary Bank to Paying Bank</i>	UCC 3 and 4 EFAA/Regulation CC Paper Clearing House Rules Federal Reserve Circular and Regulation J (only if FRB exchange) Contract	Same as box above	Same as above box.
<i>Paying Bank to Customer</i>	UCC 3 and 4 EFAA/Regulation CC Contract	EFTA/Regulation E if consumer Contract NACHA Rules impose some standards on RDFI relationship with customer (example: WSSUP).	Customer Agreement UCC 3 and 4 EFAA/Regulation CC Check 21 may apply if a substitute check is involved

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A Snapshot Of The Payments Law Patchwork

Challenges in our current payments system

- Consumers and small businesses have limited pre-presentation control over charges against their accounts – either how or when they are originated, or in what form they are presented.
- For some payment devices, the paying institution has no ability to distinguish an authorized charge from an unauthorized charge. Risk is managed through presentment warranties and time limits for challenges to the charge by account owners.
- The rights and responsibilities of the various parties to a payment transaction can vary significantly, depending on the form of the payment instruction or order that they issue, process or pay.
- What those rights and responsibilities are, and whether they may be varied by agreement, now sometimes depends on the form of the payment instruction or order *received* – regardless of what sort of payment instruction or order was originally *issued*.

A Snapshot Of The Payments Law Patchwork

A partial list of current issues at 20,000 feet

- Presentment warranties vary, depending on channel or form of payment order/instruction sent or received. They may change in mid-transaction as the form of the order/instruction changes.
- Current notices to consumers of potential post-issuance changes in payment form, and the consequences of such a change, are sometimes challenging to deliver in a form that is both effective and informative.
- The proliferation of non-financial institutions participating in the payment process as intermediaries has:
 - Outpaced the definitions and distribution of rights and responsibilities in payment systems law,
 - Created confusion concerning the credit risk associated with these participants, and
 - Resulted in a confusing patchwork of state laws concerning the charging of fees and the application of escheat and money transmitter statutes.
- The proliferation of electronic payment devices and systems has strained the definitions and structure of rights and responsibilities under existing law.

Drilling Down – Intermediary Risk in P2P Payments

Past as Prologue

PRECURSORS TO MODERN P2P

- **Electronic P2P Products**
 - DigiCash
 - Mondex Smart Cards
 - Others
- **Chief Characteristics**
 - Value “checked out” of financial system and stored on cards or special-purpose storage devices
 - P2P Payments Possible – Primarily In Person
 - Often Characterized as “Electronic Cash”

RISK AND REGULATORY ANALYSIS

- **Baxter Goes Ballistic**
- **ABA Initiative**
 - Extensive analysis of risk and structural issues
 - Seminal Report – “A Lawyer’s Take on the Electronic Purse” – published in The Business Lawyer
- **Federal Reserve Analysis – Application of Regulation E**
- **FinCen – Money Laundering Potential**

Drilling Down – Intermediary Risk in P2P Payments

Key Lessons

- P2P Payments may be electronic, but they're not cash...
 - Until the value comes to rest in a financial institution account of the intended recipient, the right to receive payment is:
 - An unsecured debt obligation,
 - Owed by the issuer or intermediary who has promised to deliver the value.
 - P2P systems that include traceable, centralized records of the movement of value are, with respect to consumer transactions, subject to the protections of Regulation E – including
 - Right to disclosures,
 - Protection from unauthorized transactions, and
 - Right to periodic statements.

Drilling Down – Intermediary Risk in P2P Payments

A Tale of Two Regulations

Federal Deposit Insurance

- **FDIC Insurance may apply to sub-accounts held by an insured depository institution**
 - Account must be held in name of a fiduciary for the principals
- **Record-keeping requirements**
 - Depository records must reflect the fiduciary relationship
 - Details of the relationship and sub-account interests of the principals must be maintained by depository or by the fiduciary

Regulation E

- **Applies to “Accounts” held by “Financial Institutions”**
- **“Financial Institution” means any person “that directly or indirectly holds an account belonging to a consumer OR that issues an access device and agrees with a consumer to provide electronic funds transfer services.”**
- **“Account” does not include an account held by a financial institution under a bona fide trust agreement**

Drilling Down – Intermediary Risk in P2P Payments

Illustrations

Intermediary Insolvency

- Allocation of loss for in-process transactions.
- Protection from third-party claims.
- Application of FDIC Insurance – structure of suspense or processing account.

Intermediary Processing

- Transaction tracking/payment confirmation?
- Misdirected payments?
- Responsibility for periodic statements?
- Application of Money Transmitter Statutes?
- Auditing and control standards – who stands in for the FFIEC and FDIC and CFPB with non-FI players?