

## Federal Reserve Finalizes Regulations for Check 21

The Federal Reserve Board has released the final amendments to Regulation CC, clearing the way for the Oct. 28 implementation of the Check Clearing for the 21st Century Act.

The late-July release offers a detailed look at the requirements that banks will face under the act and also contains a number of changes to existing provisions, made in part in response to letters received during the comment period. Here are some highlights.

- The Fed has shortened the model consumer disclosure notice. It has also specified who should receive them. Banks need to send the notice only to customers who receive substitute checks with their statements or customers who occasionally receive them. Also, banks need send only one disclosure per customer relationship. If a customer maintains more than one account at the bank, one notice will suffice for all accounts.
- Credit cards and home equity lines of credit are not considered consumer accounts under

the final regulations. If checks are drawn on either of these lines of credit, the expedited recrediting provisions of Check 21 will not apply.

- The Electronic Signatures in National and Global E-Commerce Act does not apply to Check 21, and banks do not have to comply with it when sending information electronically under Check 21. The E-Sign act provides a legal equivalency between electronic signatures and original signatures.
- Banks will be required to switch to black ink indorsements by Jan.1, 2006. The final regulations also abandon the idea of placing indorsements on the front of substitute checks.

Check 21 authorizes the creation of a substitute check, which is a paper reproduction of the original check, complete with images of the front and back. Under the terms of the act, a substitute check is granted legal equivalency with an original check. Banks are not required to create substitute checks under the act, but are required to accept them. ✕

## NACHA Update: Proposal Will Streamline ACH Network

Cash penalties will be automatically assessed for every unauthorized ACH debit transaction, under a NACHA proposal released in late July.

“This proposal accomplishes two things,” said Michael Herd, a spokesman for NACHA. “It pro-

vides a financial incentive to improve the quality of ACH transactions, and it compensates banks for the cost of unauthorized debits.”

The actual penalty, which will be between \$13 and \$18 per transaction, will be assessed against the originating deposit financial institution. The return deposit financial institutions, which up till now have borne the full cost of the returns, will receive the collected money. NACHA will formally issue a request

for comment on the proposal by the end of August, and the comment period will last 60 days.

“Unauthorized debit returns are expected to rise by 17 percent this year, so we needed to do something to lower that figure. NACHA is also looking into policing administrative returns, but that issue is a bit more complex, and we’re still studying what to do there,” Herd said.

## **NACHA Update: ARC Payments Surge in Popularity**

Accounts receivable payments (ARC) topped 208 million in the second quarter of 2004, rising by 791 percent over the previous year, according to NACHA. ARC volume is now greater than Internet-initiated consumer ACH debits, making

it the largest e-check ACH application. ARC payments totaled \$60.8 billion.

In other news, NACHA has approved an amendment to the ARC rules, requiring ARC-originating companies to give their customers the ability to opt out of having their checks converted to ACH debits. The amendment took effect June 11.

During the ARC process, a customer’s check is sent to a remittance or lockbox location and turned into an ACH electronic debit. The ARC method was approved by NACHA in March of 2002.

Ninety-three percent of ARC-originating companies already provide customers with an opt-out, said a NACHA survey, and the number that choose to opt out is often less than 1 percent. ✕

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## **Fallout Continues from WalMart/Visa/MasterCard Case**

Retailers are reaping the rewards of the WalMart/Visa/MasterCard case, according to Stan Paur, president and chief executive officer of Pulse EFT, an electronic banking network in Houston. “The pendulum has swung over to the retailers. They’ve seized the opportunity to influence electronic payments, and that’s not going to go away,” Paur said.

The lawsuit was settled toward the end of 2003, and resulted in Visa and MasterCard lowering their interchange fee on signature debit and agreeing to do away with “honor all cards” policies. Retailers have taken advantage of the settlement, Paur said, looking into a variety of electronic payment methods and costs, a position they did not

have prior to WalMart’s lawsuit.

As an example of this newfound freedom, WalMart reversed itself in early July, deciding to accept signature-based MasterCard debit cards after initially banning them in February. “WalMart has the freedom to make any kind of decision it wants now, and this latest is certainly not influenced by any issuers,” Paur said.

The decision to accept signature-based debit again was mainly cosmetic, as MasterCard signature-debit made up less than 1 percent of WalMart purchases before its ban in February. In fact, during the ban, WalMart had been accepting signature-based cards and switching them over to PIN-based transactions. ✕

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### **SVPCo Launches Image Exchange Network**

SVPCo, a provider of electronic payment and check electronification services, officially launched its Image Exchange Network on September 2. The network allows banks of any size to electronically exchange check images during the clearing and settling process, eliminating the need to physically transport the original checks. Prior to the launch, SVPCo conducted a two-month test of

the network with KeyBank and JPMorgan Chase. Check images were exchanged between the two banks at controlled volumes to test the effects of the network. Volume is expected to increase through 2005.

Banks can connect to SVPCo’s network in many ways, including through the Federal Reserve or via a correspondent bank. The network supports the exchange of electronic images and data for forward presentment, return items, and substitute check printing.

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## Perspective

# Merchant Card Services and the Third Party Agent

By James Gustafson

The hottest topic today in regards to merchant acquiring is the registration of third party agents (TPAs) and the compliance of those agents with the card associations' cardholder information security regulations. Third party agents are used to perform any number of different functions, from sales (independent sales organizations), and contract work (independent contractors) to Internet gateways and payment providers (high risk Internet payment service providers). If third party agents are used, they must be registered with the card associations and, in the case of Visa, they must be compliant with the cardholder information security program, or CISP.

The bank may contact Visa Franchise Management to determine if a TPA is registered by viewing the agent reference file (Registered agents are also on Visa USA's Web site.) The file will provide the agent's name and address and names of the principals involved. If the TPA is not registered, the bank must complete a background investigation of the agent, including an on-site inspection, and must review solicitation and sales material. Based on the type of third party agent, the applicable registration form and supporting document confirming the agent's compliance with Visa must be supplied for registration. The bank must have a written agreement with the agent and agree to do continued monitoring of the agent.

The stipulation causing the most concern to members (banks) is that they are responsible for registering TPAs whether they have established a direct relationship with the agent or whether a member's merchants established the relationship. Banks must register all third party agents, granting them access to their bank identification numbers (BINs) for the purpose of authorization, clearing,

settlement, exception item processing (chargebacks) and other services that allow the agent access to cardholder information. For example, in many cases, a member bank is not going to be aware that one of its merchants hired a third party agent to build a Web site for it to take credit card orders. Nor will the merchant know they should inform the bank.

MasterCard has been working with the other payment card brands (Visa, JCB, Diners' Club, American Express and Discover) to identify and to implement measures to safeguard cardholder information.

Working in conjunction with the other card brands, MasterCard has developed a merchant communication notice that reinforces the need for merchants and their agents to safeguard cardholder account data and alert acquirers to any vendors who have access to and/or store this data.

This merchant notification, attached to MasterCard's U.S. Region Bulletin, No. 2, dated June 15, 2004, must be sent to all merchants no later than October 31, 2004. This notice is also available in a downloadable file through MasterCard eService on MasterCard OnLine. The Web site is: [www.mastercardmerchant.com/datasecurity](http://www.mastercardmerchant.com/datasecurity).

Because of the complexity in regards to the registration of third party agents, we suggest that banks reference Visa U.S.A., Inc. Operating Regulations Section 1.4, Section 1.5.B, Section 1.7.D, Section 1.13, Section 2.5, Section 4.4, Section 5.3, and Section 9.7C.

Further information is available on the Visa Web site: [www.usa.visa.com/cisp](http://www.usa.visa.com/cisp). ✕

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*James Gustafson is vice president, client services, for Certegy Inc., a provider of credit, debit and merchant card processing, e-banking, check risk management and check cashing services.*

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## Contactless Payment at the Fast Food Restaurant

McDonalds has reached an agreement with MasterCard to install the contactless PayPass solution in restaurants located in New York and Dallas later this year. Additional McDonalds locations will be equipped with PayPass in 2005.

The PayPass card allows cardholders to tap or wave their card over a PayPass terminal, completing transactions without having to swipe a card or hand it to anyone. The cards have a built-in radio frequency chip as well as a magnetic stripe, and can be used either as a contactless form of payment at a PayPass terminal, or as a traditional credit card.

McDonalds already accepts cashless payment options at more than 4,500 locations in the U.S., and will increase that number to 8,000 by the end of the year. ✕

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## Counterfeit Card Fraud Increases Dramatically

Counterfeit card fraud has more than doubled over the last five years, according to a report from Datamonitor, an independent market analyst in London.

Fraud losses from the practice accounted for \$211 million in 2003, compared to \$95.6 million in 1999. Fraud losses increased by 30 percent in 2003, accounting for 14 percent of total fraud losses.

Smart card technology, where a chip is implanted into the card, has been shown to reduce counterfeit card fraud, but its adoption in the United States has been very limited, Datamonitor said. ✕

## News Bytes

> MasterCard has teamed up with NameProtect Inc., a digital asset protection company in Madison, Wis., to help prevent phishing attacks and illegal credit card use. Under the terms of the partnership, NameProtect will scan the Internet for any suspicious activity, such as illegal use of the MasterCard logo.

> Ninety-five percent of checking account holders have no idea what Check 21 is, according to a poll conducted by Harris Interactive. Acting on behalf of NCR Corp., Harris Interactive interviewed 2,148 U.S. citizens. Out of that number, 2,010 maintained checking accounts. Check 21 will be implemented on October 28, granting legal equivalency between a substitute check and the original. Banks are required to inform their customers of Check 21 before October 28.

> SVPCo, The Clearing House, and several other payments-related businesses have banded together into a single payment company with a unified governing board. Other companies making up the new organization include the Clearing House Interbank Payments System, the Electronic Payments Network, the Electronic Clearing Services and the National Check Exchange. The new organization will be phased in over the next year.

> The Federal Reserve Board has announced that check processing at nine facilities will be discontinued, with operations being shifted to other locations. The changes will occur in 2005 and early 2006. The affected facilities are: Boston, Columbus, Ohio, Birmingham, Ala., Nashville, Tenn., Detroit, Oklahoma City, Houston, Portland, Ore., and Salt Lake City. This latest move is a continuation of the Fed's restructuring of the check processing system. By the end of 2004, the Fed will have reduced check-processing facilities from 45 to 32. The newly announced closures will take that number down to 23 by 2006.

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