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Introduction

by GEORGE W. MITCHELL*

The Electronic Fund Transfer Act¹ resulted from the work of the National Commission on Electronic Fund Transfers.² The Commission's Final Report³ was filed October 28, 1977; the EFT Act was enacted November 10, 1978. The Commission's findings dealt with several aspects of the electronic transfer of deposits, principally: (1) the probable impact on consumers in making or receiving payments; (2) the regulatory responsibility and participation by government and the Federal Reserve in assuring accessible, efficient and reliable electronic services; (3) the role of banks and other depository institutions in offering such services on a competitive or cooperative basis; and (4) the ready availability of technological innovations to public and private offerors of electronic transfer services.

The Commission made over one hundred separate recommendations⁴—most of them advisory, exhortatory or admonitory. Its legislative recommendations were intended mainly to identify and establish consumer rights and liabilities. To some degree, the Commission incorporated the rules for the payment of checks set forth in the Uniform Commercial Code as ground rules for EFT. In its recommendations for statutory changes, the Commission generally did not attempt to determine whether state or federal legislation was more appropriate, and this was its position on consumer-interest items.⁵ However, at the Congressional hearings held to review the Final Report, some witnesses recommended that the U.C.C. be

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1. 15 U.S.C. §§ 1693-93r (1978) [hereinafter cited as EFT Act].

2. 12 U.S.C. §§ 2401 *et seq.* (1976).

3. NAT'L COMM'N ON ELEC. FUND TRANSFERS, EFT IN THE UNITED STATES: POLICY RECOMMENDATIONS AND THE PUBLIC INTEREST (1977) (final report) [hereinafter cited as FINAL REPORT].

4. *Id.*

5. *See, e.g., id.* at 68-71.

extended to cover electronic transfers, rather than passing a federal EFT law that would preempt state laws and regulations.⁶ In the end, Congress chose to provide a basic level of consumer protection at the federal level, and allow the states to enact more protective legislation if they felt it desirable.⁷

The act that Congress adopted endorsed EFT as having the potential for substantial benefits to consumers,⁸ but did not indicate what EFT had in store for the depository institutions that were expected to offer electronic transfer to their customers. This is a major industry problem, as EFT is no small thing for commercial banking. The industry as a whole cannot take it or leave it. Electronic transfer is unquestionably the most efficient way—resource cost, energy and time-wise—of making deposit transfers today, and the decision on how to shift from paper to electronics cannot safely be deferred to the next generation of banking chief executive officers.

The change-over involves a number of investment and management decisions for the industry because, over time, electronic transfer will drastically reduce the need for branch offices, tellers, vaults and related facilities. Moreover, as paper checks and cash are displaced, the transportation of the evidence of payment will be shifted to electronic communications and away from the surface and air couriers and the Postal Service now used for paper instruments.

The bundle of money services long offered by commercial banks has been the cornerstone of banking around the world. Today, the *de facto* monopoly that commercial banks have on such services is being eroded both by other depository institutions and by such innovators as credit card companies using widely available technological expertise in communication and data processing. Such innovators are perfectly capable of carrying off the cornerstones of commercial banking unless commercial bankers match such expertise in their own operations.

Can commercial banking afford to give up money transfer service? Today, net demand deposits are less than twenty percent of commercial bank assets, compared to fifty-four percent in 1955.⁹ Will that trend continue? Will it be aborted by automatic transfer between demand and savings accounts? Commercial banks cannot

6. *Consumer Protection Aspects of EFT Systems: Hearings Before the Subcomm. on Consumer Affairs of the Senate Comm. on Banking, Housing and Urban Affairs*, 95th Cong., 2d Sess. 74-75 (1978) (response of Professor H. Scott).

7. 15 U.S.C. § 1693q (1978).

8. *Id.* § 1693a.

9. Figures for the current year are shown in FED. RESERVE BULL., Sept. 1979, at A18 (table 1.26). Figures for 1955 are shown in FED. RESERVE BD., BANKING & MONETARY STATISTICS, 1941-1970, at 28 (table 1.3).

afford to give up money service because of its linkage to other funds sources and to the merchandising of profitable, consumer financial services. Savings and cooperative banks in Europe learned long ago that money transfer service is vital to serving their consumer customers. Their counterparts in the United States are coming to the same conclusion.

The operational essence of money transfer—data processing, storage, and communications—lies in one of the few areas where operating costs continue to decline dramatically as a consequence of technological advances. Banks have already embraced electronic processing and storage, but still sort and return checks to customers, keep facsimiles and, as an industry, have not encouraged their customers, through comparative pricing, to initiate their money receipts and disbursements electronically. Customers' transactions are still handled as if the written check were not only the best, but the only, way of effecting a deposit transfer. The check, an instrument devised to expedite payment, has become a contrivance used by some persons to defer payment. Today, from a technological standpoint, the check is functionally obsolete; it is part of the first-class mail service generation, which a recent study found depended on financially-related communications for eighty percent of its volume.¹⁰

In most European countries, income payments (wage, salaries, social security, etc.) do not involve checks, but have been for some time directly credited to the recipients' account in one or another type of financial institution. Today, magnetic tape is used to save three-quarters to four-fifths of the transaction costs of paper transfers. Additional savings are possible as direct communication between computers via wire or satellite displaces all paper and non-local magnetic tape movement.

Assuming that money services are vital to commercial banking, electronic fund transfers, by exploiting data processing and communications technology, become the catalyst for an orderly transition away from paper-based systems. How this comes about depends on competition and regulation.

If there were no competition to commercial banking from other depository institutions, credit cards, mutual funds, and professionals in data processing and communication, EFT technology might safely be ignored. Apart from the attrition caused by steadily rising transaction costs, and the cyclical fluctuation in interest rates causing

10. *Recommendations of the Commission on Postal Services: Hearings Before the Subcomm. on Postal Operations and Services of the House Comm. on Post Office and Civil Service*, 95th Cong., 1st Sess. (1977).

more and higher fees for money services, the public could be served as in the past. This, however, is the very environment that those equipped to utilize decreasing cost technology can exploit. It is not difficult to conceive of a money service that is only marginally based on the existence of deposit accounts; indeed, it is being offered today by mutual funds and certain debit cards. While banking flounders in its own paper inheritance, institutions in that "outer financial space"—thrifts, mutual funds, and innovative enterprises in other guises—electronically chip away at banking's cornerstone.

Will banking be protected by regulation against the threat of competitive suppliers of money services? It seems not. While one function of regulation historically has been to protect depository institutions from the ravages of competition in the interest of continued institutional viability, recent trends have been toward enhancing competition among banks and from other depository institutions. Today, consumer protection legislation and implementing regulations have become broad-based and pervasive. Though competition is widely recognized as a major safeguard protecting consumers from predatory business practices, regulation also has an essential role. Even when consumers can see, feel, or otherwise sense a product or service being purchased on the spot, their interests still demand the protection provided by honest labeling and open pricing regulations. The same is true in the banking industry.

Banking has always been a personal business where terms, prices, liabilities, and prerequisites commonly have been variable—usually in relationship to the value of a particular customer's business. Frequently, terms are unspecified in advance and unknown by customers. Correcting uncertainties of this type is the most significant step that can be taken to remove exposure to regulatory costs and burdens.

What is the cost of regulation? Who pays for it? Does it become an overhead cost element leading to higher prices, or do regulatory aggravations lead to the withdrawal of services from the market? Do regulations which serve the interests of a very small fraction of the population warrant the burden placed on everyone else? Questions of this type need to be addressed, even though specific answers are difficult, if not impossible, to obtain.

In a \$2.25 trillion economy, a few billions of dollars in regulatory friction and cost is barely visible. That fact, however, does not justify marginal expenditures, nor is it persuasive to the businesses or consumers who perceive and measure their costs and benefits arising from a specific regulation.

Both users and providers of EFT services can gain from effec-

tive regulation, if they agree on cost-effective measures to establish their respective rights and liabilities. Consumers will also gain from precise knowledge of the character of services offered and their price in terms of balances, fees and availability. The present payment system is not cost effective, because user behavior is not guided by prices toward more efficient payment practices. Costs are little used in pricing because they are widely and haphazardly dispersed among payors, payees, depository institutions and public agencies. Many costs are unknown though knowable. Others are obscurely "joint" or lost in "overheads." "Bundling" is pervasive. As there are two sides to every transaction, how should the cost be split between the payor and payee—charging both, sometimes one, sometimes the other or, ostensibly, neither? When labor was cheap, energy plentiful and competition in payment services controlled, these questions were *de minimus*; however, with paper transaction costs at fifty cents per item and rising,¹¹ while cheaper electronic alternatives are available, economics should be allowed to play a larger role. Pricing money transfer services at full cost will encourage the conservation of resources and the exercise of consumer preferences.

Section 914 of the EFT Act¹² specifically states that the Act does not prohibit private agreements between a bank and consumer that provide the consumer with more advantageous terms. The Act thus encourages the development of superior banking practices by providing that the statute gives way to transaction terms that offer consumers more extensive rights or greater protections. As admirable as the statutory standards of the Act may be, it should not be difficult for a depository institution to better many of them. Such a view of the Act—not as a high water mark, but a low water mark in consumer and institutional relationships—would be a most constructive approach in perusing the contributions to this issue of the *Computer/Law Journal*.

11. G. Mitchell, *Technology and Banking* (speech given in Zurich, Switzerland, on Oct. 9, 1979).

12. 15 U.S.C. § 1693l (1978).

