

Committee Name:

**Senate Committee – Privacy, Electronic Commerce and Financial Institutions
(SC–PECFI)**

Appointments

01hr_SC–PECFI_Appoint_pt00

Clearinghouse Rules

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Committee Hearings

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Executive Sessions

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Hearing Records

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Misc.

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Record of Committee Proceedings

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SB 417 – Demand Draft Testimony

- This bill is not simple – but it’s goals are -- protecting consumers and their financial institutions from unauthorized drafts from a consumers account. The proposal places the liability for **unauthorized** “demand draft” or “tele-check” checks on the institution that drafted the check.
- Businesses can create a check(draft) from a consumer’s account with “authorization” from the consumer and the check is required to be processed by the consumer’s financial institution unless the consumer notices the unauthorized draft and stops the transaction.
- Unlike credit cards and debit cards, consumer and financial institution protection is not there for “demand drafts”. No signature is required to cash these demand draft checks, where the signature normally is, the merchant/telemarketer prints "Debiting of Account Authorized by (customer name)."
- The Jeskewitz/Erpenbach proposal shifts the initial risk of loss from one bank to another. It does not impair or affect in any manner a consumer’s right to question the payment of unauthorized items from the consumer’s account. The financial institution of the business that has drafted the check is liable for unauthorized drafts.
- Similar laws have been passed in California, Hawaii, North Dakota, Oregon, Texas, Utah, Colorado, and West Virginia.
- **According to the Community Bankers of Wisconsin, last year’s losses to Wisconsin consumers were \$2.8 million and Wisconsin financial institutions lost \$1.75 million in that same time period.**

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**Public Hearing of the
Assembly Committee on Financial Institutions And
Senate Committee on Privacy, Electronic Commerce and Financial Institutions
AB – 784 & SB – 417 Demand Drafts**

**Testimony of Daryll Lund, President & CEO
Community Bankers of Wisconsin**

Chairperson Jeskewitz and Chairperson Erpenbach and members of the committees, my name is Daryll Lund, President & CEO of the Community Bankers of Wisconsin (CBW). CBW is a statewide trade association representing the interests of approximately 220 community based financial institutions.

I appear before you today to testify in support of AB - 784 & SB - 417. The CBW strongly supports passage of these bills that will regulate the negotiation and collection of demand drafts.

Third party drafts, sometimes called demand drafts, telechecks, preauthorized drafts or unsigned MICR (Magnetic Ink Character Recognition) drafts, are drafts which have been initiated by a person other than an owner of the account on which the draft is drawn (the "account owner"), and which does not contain the actual signature of the account owner. The person initiating the draft claims to be acting pursuant to the authorization of the account owner.

Based on the Uniform Commercial Code when the account owner has authorized its initiation, a third party draft is a legitimate payment instrument and its payment presents no special problems for financial institutions. However, when a third party draft is initiated without such authorization, the potential for consumer and bank liability arises. This problem has become more serious in recent years with the increased fraudulent issuance of third party drafts, particularly in connection with telemarketing programs and Internet purchases.

To determine the extent of the problem and losses caused by unauthorized third party drafts a survey was conducted by the Community Bankers of Wisconsin (CBW), Wisconsin Automated Clearing House Association (WACHA) and the Upper Midwest Automated Clearing House Association (UMACHA). The survey involved Wisconsin financial institutions (commercial banks, savings banks, savings and loans and credit unions).

Financial Institutions Survey Results

Survey results are based upon the experience of Wisconsin financial institutions over the past year.

Direct Costs

- Losses to Wisconsin consumers (\$2.8 million) and Wisconsin financial institutions (\$1.75 million) were estimated at over **\$4,500,000**. One financial institution had losses of \$260,000.

Indirect Costs

- It is the practice of a majority of the financial institutions to close out an account once a fraudulent or unauthorized transaction has taken place. This results in additional costs and inconveniences to the consumer because new checks and debit cards must be ordered as well as any changes to direct deposits or automated clearing house (ACH) must be made.

Identity Theft

- The natural progression in these types of transactions is identity theft. Once an unscrupulous individual or business has an individual's account information it is likely that additional unauthorized transactions will occur until the problem is identified. Reviewing monthly bank statements can identify unauthorized transactions. However, an estimated 85% of consumers do not review their bank statements. Generally, if a consumer is the victim of a fraudulent or unauthorized transaction, they have 14-30 days after they receive their statement to notify their financial institution of the problem. If they don't notify the financial institution in that short time frame the consumer is usually responsible for the loss.

Other

- One community bank monitored every third party draft over a 16-month period (2,032). If the bank did not have written authorization from their customer a telephone call was made to the customer asking for authorization. **The result, 73% of the third party drafts were returned as "unauthorized".**

The Community Bankers of Wisconsin respectfully requests your support of AB-784 and SB-417. Thank you for your consideration.

**Public Hearing of the
Assembly Committee on Financial Institutions And
Senate Committee on Privacy, Electronic Commerce and Financial Institutions
AB - 784 & SB - 417 Demand Drafts**

**Testimony of Richard McGuigan, Executive Vice President
Community Bankers of Wisconsin**

Chairperson Jeskewitz and Chairperson Erpenbach and members of the committees, my name is Richard McGuigan, Executive Vice President of the Community Bankers of Wisconsin (CBW).

I appear before you today to testify in support of AB - 784 & SB - 417.

My testimony will focus on the technical aspects of the check collection process and to explain what this legislation will address and correct in the check collection process.

Articles 3 and 4 of the Uniform Commercial Code were revised in 1990. Those revisions were adopted in Wisconsin in 1996. The revisions encourage the use of automation by banks to process checks. As a result, some abuses by unscrupulous companies and crooks have developed.

An increasing number of consumer purchases for goods and services are made **over the telephone and by computer**. Today, there are generally four ways for the consumer to pay for the purchase: check, credit card, an electronic debit to the consumer's account by using the Automated Clearing House system (ACH), or by providing the merchant/telemarketer ("merchant") with their checking account information and thereby "authorizing" the merchant to create a paper check that is used to debit the consumer's account. Where the signature would go on the paper check, the merchant prints a legend like "Debiting of Account Authorized by [Customer]." These preauthorized drafts, also called "telechecks," are the subject of the proposed legislation.

With credit card and ACH transactions, if the consumer has a problem with the merchant, or didn't really authorize the transaction, the consumer and the consumer's bank have a number of protections that allow the transaction to be reversed. With preauthorized paper demand drafts ("telechecks"), it is much more difficult for the consumer to prove that the transaction was not authorized, and it is extremely difficult for the consumer's bank to return these preauthorized demand drafts to the financial institution where the

merchant has its deposit account ("depository bank"). In effect, by creating a paper check allegedly authorized by the consumer, the merchant is able to circumvent many consumer protection regulations.

The proposed legislation would protect consumers and their bank from persons that initiate unauthorized paper demand drafts and would shift the *initial* risk of loss from the consumer's bank to the originating/depository bank in the following ways:

- The bill makes the consumer protections compatible with that of the national electronic funds transfer laws (Regulation E and ACH) that have been in effect for years. Under those regulations, the *initial* risk of loss is placed on the originating/depository bank.
- The bill places the loss for unauthorized transactions on the merchant or the originating/depository bank they opened their business account with rather than on the consumer's bank by creating a **transfer warranty** that states that the creation of the paper demand draft was authorized by the person identified as the "drawer."
- The bill merely **shifts the *initial* risk of loss from one bank to another**, and *does not impair or affect in any manner* a consumer's right or ability to question the payment of unauthorized items from the consumer's account.
- Because the originating/depository bank (the merchant's bank) would warrant that the paper demand draft was authorized by the consumer, the depository bank would be forced to investigate the merchant carefully before opening the account.

To date, virtually identical legislation has been passed in eight states - California, Hawaii, North Dakota, Oregon, Texas, Utah, Colorado, and West Virginia. Uniform legislation for all states is currently under consideration.

Thank you for your consideration.

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Check Processing Work Flow

