



## A Summary of the Electronic Payment Order Forum

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### Introduction

On March 28, 2013, the Federal Reserve Bank of Atlanta hosted an Electronic Payment Order (EPO) Forum with payments industry participants, including banks, nonbank payment service providers, retailers, and regulators. The Forum focused on the attributes of EPOs, their potential uses, and the legal and regulatory environment for EPOs. The goal of the Forum was to understand characteristics of EPOs in meeting business needs, to define attributes of EPOs relative to other payment types, and to evaluate the use and impact of EPOs within the broader payments industry. Following is a summary of the major themes discussed during the Forum, and proposed next steps.

### Major themes

#### *Definition of an EPO*

At the onset of the Forum, participants had a general understanding that EPOs are in use but agreed that, because EPOs are indistinguishable from other electronically processed checks, their volume is difficult to measure. While it's clear that EPOs exist in the payments system, there is less clarity or consensus around their exact definition. Lawyers participating in the Forum recognized that "check" is defined by law, and that checks and remotely created checks (RCC) are further defined by regulation, and offered the following descriptions of different types of EPOs. Other participants contributed descriptions of other closely related products.

- **Drawer-issued EPO:** An electronically-created order, issued by the drawer of the order, with all other characteristics of a check. The drawer's "signature" is typically applied electronically by the drawer upon creating the item.
- **Payee-issued EPO:** An electronic equivalent of an RCC. The "signature" is often in the form of the drawer's name and/or a statement indicating that the drawer authorized the order.
- **Paying-bank-issued EPO:** An EPO issued by the paying bank on behalf of the drawer. The "signature" can be in the form of the drawer's name and/or a statement indicating that the drawer authorized the order, but authenticity of the signature is

less of a problem because the paying bank is the creator of the item by agreement with the drawer.

A common understanding of the EPO is critical to identifying and weighing use cases for the concept as well as for establishing the applicable legal and regulatory structure. Therefore, an important next step is to gain consensus around a description for EPOs, which could include one or more of the items described above.

#### ***EPO attributes and special use cases***

While the laws and regulations governing payments do not provide clear coverage for EPOs, potential use cases still exist for the payment type. This is due likely to the attributes associated with EPOs (for example, paperless creation) and the assumption that EPOs would be processed over check rails and subject to the legal framework governing paper-originated checks.

Improved speed can result from eliminating mail float associated with sending a paper check, thereby minimizing clearing and settlement time. Participants also pointed to payment finality as an attractive element of EPOs, assuming they are subject to check laws and rules. The participants compared check-based payments to ACH debit transactions, which can be returned through the ACH system by receiving banks up to 60 days after the initial settlement date under certain circumstances. Participants noted that, while checks could be subject to warranty claims long after the initial settlement date, those claims are typically handled outside the normal check collection and return system.

Participants cited lower costs of EPOs compared to checks, resulting from eliminating the paper in the origination of the payment order, eliminating payment processing and mail float, and eliminating postage and mail-related supplies. Participants also noted lower costs that result from reducing fraud through positive authorization by the payer, eliminating mail interception, and enabling quicker fraud detection through a faster deposit scenario.

In addition, participants noted the advantage of ubiquity with EPOs that arises from mass use of checking accounts, especially by the business sector, and the ability to reach a large population by not requiring the account information of the intended recipient. By way of example, all businesses have demand deposit accounts, while large numbers of businesses are not enrolled through their financial institutions to originate ACH. Participants cited the time and financial requirements to enroll in ACH (similar to obtaining a line of credit) and the time and cost of educating users on NACHA rules as barriers to enrolling businesses in ACH.

All of these features—speed, finality, relatively low cost, and ubiquity—that EPOs possess, assuming they are governed by check law, are important in moving large volumes of payments made by businesses and consumers. With this in mind, panelists cited potential use cases for business-to-business (B2B) payments, consumer-to-business (C2B) payments, and business-to-consumer (B2C) payments. EPOs are a viable payment method for both

small and large businesses because of the speed in clearing and settling them, the finality of payment, their low cost, their ubiquity, and their familiarity (they look similar to check payments). They also carry data sufficient for the reconciliation of account information in many instances, and could potentially carry richer data without drastically altering current processes. For example, C2B payments, which include consumer bill payments, and B2C payments, which include insurance reimbursements, could be effectively carried out by EPOs.

#### ***Legal environment and potential approaches***

The legal panel made it clear that the legal framework for checks does not specifically address or apply to EPOs. The laws and rules that apply to checks<sup>1</sup> are written in terms of instruments that originate as paper, but EPOs begin as electronic documents. Even though check law applicability has been altered by agreements over the years to address innovations that generated new check products, such as check image exchange agreements, the technology innovations that have led to an electronic-generated order have not seen a commensurate alteration of the laws, regulations, or rules.

Many features of check law were written specifically to apply to written paper instruments and thus may not fit neatly with EPOs, even if check law were to apply to EPOs by agreement or by legislative or regulatory change. These features include concepts of negotiability and transfer and presentment warranties. Another issue of concern is that the EPO may be subject to the Electronic Fund Transfer Act (EFTA), a law that governs the relationship between the consumer and its account-holding institution for electronic fund transfers. Forum participants indicated that this legal uncertainty is an impediment to further use of EPOs. The legal panel explored the process for changing the applicable set of rules to address the uncertainty about EPO coverage, in terms of degree of difficulty and universality of application.

- Revising statutes (federal or state) would be the highest hurdle, but would establish the most authoritative legal structure for EPOs. Panelists alerted participants that statutory provisions governing EPOs could come in the “side door” through legislation aimed at particular practices, citing a bill recently introduced to address payday lending that contained rules for RCCs.
- Revising regulations could be possible, but may be hampered by the strictures of agency statutory authority.
- Establishing agreements between parties who use and process EPOs is the most nimble approach. However, agreements bind only those who choose to participate. Complimentary changes to the Fed’s Operating Circular (OC) 3 and the Electronic

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<sup>1</sup>See, for example, Articles 3 and 4 of the Uniform Commercial Code, the Expedited Funds Availability Act (12 U.S.C. 4001 et seq.), and the Check 21 Act (12 U.S.C. 5001 et seq.), as well as the Board’s Regulation CC (12 CFR Part 229) and Regulation J (12 CFR Part 210)

Check Clearing House Organization (ECCHO) rules could possibly make this a viable course.

Even if the industry were to take on a project to establish a rule set for EPOs through one of the mechanisms listed above, there remains the question of what those rules should provide. The legal panel discussed options for participants to consider, including:

- Treat EPOs as if they are checks. Are all of the provisions of check law appropriate for EPOs? For example, should the provisions of the Board's Regulation CC apply to EPOs? All of Regulation CC or some subset? By way of illustration, the panel discussed a previous amendment to Regulation CC to address RCCs, which shifted the liability for unauthorized RCCs to the depository bank, the bank for the person who initially created and deposited the RCC. Since RCCs do not bear the signature of the drawer, the policy behind the revisions was to shift the burden of ensuring authorization of an RCC to the bank whose customer deposited the RCC since that bank would be in the best position to detect fraud. The panel raised the issue as to whether the Board should consider a similar "targeted" approach for EPOs and drew participants' attention to the Board's 2011 request for comment on that issue and on broader application of Regulation CC to EPOs in general.
- Treat EPOs as electronic fund transfers. The panel noted that, even if Regulation CC is amended to specifically address EPOs for processing purposes, EPOs may still be subject to the EFTA. The EFTA establishes the basic rights, liabilities, and responsibilities of consumers who use electronic fund transfer services and of financial institutions that offer these services. Given the definitions in the EFTA, EPOs that debit consumer accounts are arguably electronic fund transfers under EFTA. (Transactions originated by checks, drafts, or similar paper instruments are excluded from Regulation E's coverage.) Interpretation of the EFTA is under the jurisdiction of the Consumer Financial Protection Bureau.

The legal panel also briefly discussed the risk posed by the existence of business method patents that apply to the issuance, collection, and/or return of EPOs. If one assumes that inventors have filed for patent protection with respect to these business methods, the lawyers suggested that the industry might need to address intellectual property issues and the associated litigation risk before committing to any particular technological solution for EPO issuance, collection, and return.

To sum up the legal perspective, the statutory requirement for a check to have its genesis in paper form is a barrier to the adoption of EPOs. While multiple approaches may exist to establish a legal framework that adequately addresses EPOs, none of the approaches discussed appear to address all the legal uncertainties with respect to EPOs.

#### ***Role in a broader payments strategy***

The Federal Reserve Bank of Atlanta's First Vice President and Chief Operating Officer, Marie Gooding, set the stage for the EPO Forum. She encouraged participants to offer their

unique perspectives, while at the same time considering the broader payments system and evaluating whether EPOs have a place in the system, be it short- or long-term. The third panel considered this question.

In its most basic form, the payment need that the payment industry participants described was a ubiquitous credit push payments system, with fast clearing and settlement. Should the focus be on creating this system, or on altering other existing products and systems to meet this need? The creation of such a system, if pursued, would be a long-term endeavor. However, several financial institution and payment provider participants urged a practical and short-term solution, one for which EPOs appeared well suited. The rationale for the position was that EPOs are an existing technical solution that can quickly allow the check processing infrastructure to realize efficiencies, an obvious one being the elimination of creating and mailing paper-originated checks.

Following on this practical and short-term approach, several participants supported implementing EPOs in a specific segment of the market, where the pain of payments inefficiencies is most keenly felt. The B2B segment was proposed as one such market because most B2B payments are still made by check. By focusing on the B2B segment, the uncertainty of the applicability of EFTA could be avoided, as EFTA's protections apply to consumers and not businesses. One proponent of this approach offered his business model and customers in the health care payments arena to be used as a case study to fully understand the business need and operational considerations for use of EPOs.

## **Conclusion and next steps**

### ***Conclusion***

Significant changes have taken place in the payments system over the past several years, with technology as a major enabler of these changes. Technology has eliminated paper in the "last mile" of check processing, and technology exists to eliminate paper in the "first mile." However, the legal and regulatory structure presents barriers to taking advantage of the technological possibilities to eliminate paper-originated checks.

The EPO exists despite these barriers, and Forum participants cited use cases for which EPOs could be an efficient payment solution. The payment industry participants recognize that a ubiquitous and fast credit push payment system is needed. However, implementing such a system would be a long-term effort and would add another payment system to a market that already has a plethora of payment systems. In the meantime, proponents of the EPO see the opportunity to use existing technology to wring out efficiencies in an already-existing check processing system. Many bankers and payments providers believe the way to move forward is to implement a limited version of EPOs, focusing on the B2B market segment because of its inadequate and inefficient payments solutions.

Participants who use EPOs without universal agreement of all the parties do not have a well-founded legal basis for that use, given the state of the applicable law today. Legal

experts attending the Forum were clear that statutory or regulatory change in this area would be challenging though not outside the realm of possibility or feasibility. Currently, the ECCHO Rules are clear that an EPO is not an item and thus cannot be exchanged within the purview of those rules. Federal Reserve Bank OC 3 imposes on the sending bank a warranty that any check image and related data that is sent to a Reserve Bank was in fact captured from a paper check. In addition, the sending bank indemnifies the Reserve Banks against any claim, damage, or loss that results from a breach of the “anti-EPO” warranty. The result has been that many providers of check collection services continue to incur the cost of issuing paper checks and capturing images from the checks, while some providers of payment services take on the risks of skipping the paper issuance (presumably reflected in their pricing) and send EPOs through the Reserve Banks. Regulation CC may be one avenue for regulatory coverage of EPOs, at least in part, and the Board continues to review the issues raised in its 2011 request for comment.

Clearly, there is additional work that will be done in part by public law and rule making and in part by private-sector agreements. Based on the discussion at the Forum, it is not clear yet what the legal outcome will or should be.

#### **Next steps**

In concluding the Forum, the Federal Reserve committed to providing a summary of the event and proposing next steps. The Federal Reserve suggests the following next steps:

1. Establish small industry work groups and, using the descriptions of different types of EPOs identified in this summary, develop use-case- or hypotheses-based review of potential future uses for B2B (especially health care), B2C, C2B (especially online bill pay), P2P, and government payments.

The Retail Payments Office of the Federal Reserve Bank of Atlanta will lead this effort, with completion targeted at year-end 2013.

2. Based on the output of the work groups, determine if there is a place for an EPO solution and if this solution fits into the broader Federal Reserve Financial Services strategic plan.