

ELECTRONIC FUNDS TRANSFER SYSTEMS JOINT SUBCOMMITTEE  
OF THE  
STANDING COMMITTEES ON COMMERCE

Report to the Members of the  
Second Session of the Sixty-sixth General Assembly  
State of Iowa  
1976

F I N A L R E P O R T

ELECTRONIC FUNDS TRANSFER SYSTEMS JOINT SUBCOMMITTEE

January, 1976

House Concurrent Resolution 63 introduced in the House during the 1975 Session requested that an interim study be made to facilitate the enactment of informed and responsible legislation respecting the use by financial institutions of electronic funds transfer systems. The resolution specified the following:

"That considerations of the Study Committee include, but not be limited to the following: The effects of such systems on the individual banks, savings and loan associations, and credit unions operating in this state; the potential interrelationships between those various types of depository institutions and the resulting interrelationships between the affected regulatory agencies of this state; the problems of security, confidentiality and documentation of transactions engaged in by means of those systems and the potential uses and abuses of the ownership of, and the agreements and practices incident to, electronic transfer systems or parts of systems."

The resolution also directed that the Study Committee submit a report and proposed legislation to the 1976 General Assembly.

At its June 16, 1975 meeting, the Legislative Council authorized the appointment of a joint Subcommittee of the Senate and House Standing Committees on Commerce to undertake the EFTS study. Members of those standing committees who subsequently were appointed to the joint subcommittee were as follows:

Senator Lowell L. Junkins, Chairperson  
Senator Robert M. Carr  
Senator Warren Curtis  
Representative Arthur A. Small, Jr., Chairperson  
Representative Robert F. Bina  
Representative Glenn F. Brockett

At the organizational meeting of the Subcommittee, held on October 20, 1975, Representative Arthur Small was elected Chairperson of the Subcommittee, and Senator Warren Curtis was elected Vice Chairperson.

At its initial meeting, the Subcommittee determined that there is a lack in the state of publicized information about the nature, purposes, uses and effects of electronic banking facilities. The Subcommittee held two subsequent hearings for the purpose of acquiring information, and written and oral testimony was received from the Iowa Superintendent of Banking, the Iowa

Bankers Association, the Iowa Independent Bankers, the Independent Bankers Association of America, several representatives of both state and national banks doing business in Iowa, representatives of retail grocery stores involved at the time in experimental EFTS programs, and representatives of banks of Iowa Computer Services, Inc.

The Subcommittee determined not to recommend any legislation, but submits this Final Report of its study.

#### PERSPECTIVES

The term electronic funds transfer systems refers, in general, to innovative electronic methods of completing transactions long familiar to financial institutions. The term itself has no fixed meaning, and the Subcommittee was advised that discussions of EFT systems require more specific referents. Testimony established that there basically are three types of systems as seen from the viewpoint of the consumer:

1. Automated Teller Machines (ATMs). Also referred to as customer-bank communications terminals, or CBCTs, these units effectively perform those kinds of functions which traditionally have been performed by tellers. The units are unmanned.

2. Customer Service Terminals. These units, generally, are less sophisticated than the ATM, and ordinarily are conceived for use within retail establishments. They are designed to provide convenience services for customers of the retail merchant, including check cashing. There is no precise description of the function of this type of terminal, but commonly it is understood to mean a facility operated by employees of the merchant.

3. Point of Sale or POS Terminals. These units are designed to be located at check-out points in retail establishments and permit the transfer of funds from an account of the customer to an account of the merchant. Because of the location of these devices, the number of anticipated functions is quite limited. Personnel of the merchant also would operate the POS terminal.

The remainder of an EFT system could vary between a single transmission line (via the telephone communication network) connected to a single bank computer, and a complex computer network providing for the routing of signals from many different consumer terminals to many different financial institutions.

Information received by the Subcommittee indicated that several different types of systems are being planned for use in the state of Iowa, although at the time hearings were being held by the Subcommittee only one system actually was in operation. Some other systems will be operational in 1976, at least to a limited extent.

An issued which received attention by the Subcommittee, although indirectly related to the main purposes of study, was the

effect of the moratorium language contained in the 1975 legislation (Senate File 536; Acts of the Sixty-sixth General Assembly, 1975 Session, Chapter 240; hereinafter referred to as Senate File 536). Senate File 536 contained controversial language relating to the operation of experimental systems between January and July of 1976. That language, contained in sections 2 and 3 reads as follows:

"A plan may not be approved by the superintendent of Banking to permit the operation of such satellite facilities after the first day of January, 1976."

An opinion of the attorney general was issued October 24, 1975, and was directed to Thomas H. Huston, Superintendent of Banking, which construed the words "may not" to have the effect of giving the superintendent the discretion of approving or not approving a plan after January 1, and that an experimental plan when approved could be operated after January 1. The opinion was discussed at length by the Subcommittee, and although there was no general agreement as to the legal effect of the above quoted language, it was agreed that some authoritative decision was necessary. At the Subcommittee meeting on December 1, Mr. Thomas Huston advised that the department of banking deemed the attorney general opinion dispositive of the issue, and that the department intended to permit continued experimental operations after January 1.

In summary, at least rudimentary EFT systems are in use in Iowa at present and several others are in the planning stages. From the testimony presented before the Subcommittee there does not appear to be any uniformity of thought about what constitutes a workable system. In addition, there are, as indicated below, issues of law which remain unanswered and which must be resolved before a more accurate description of EFT systems in Iowa can be offered. Nevertheless, the Subcommittee did receive testimony on many of the questions involving EFTS operation.

#### COMPETITION AND EFT SYSTEMS

One of the areas of impact of which the resolution directed study is the effect which EFT systems will have on individual banks, savings and loan associations, and credit unions, and on the interrelationships between those various institutions. The advent of electronic systems, it was stated to the Subcommittee, will influence not only the competitive relationship between like institutions, (e.g., bank against bank) but also will have a significant impact on competition between the industries (e.g., banks against savings and loan associations).

#### Intra-industry Competition

Some members of the Subcommittee expressed at the first meeting a concern that the smaller banks would be seriously disadvantaged by the ability of larger banks, both within and outside Iowa, to operate electronic consumer terminals in close proximity to those small institutions. Although not verbalized, a

similar concern would seem appropriate for those smaller savings and loan associations who compete with more financially endowed associations. Because of the relatively unique nature and function of credit unions, perhaps there is less cause for concern as between those institutions.

Testimony was received by the Subcommittee on the intra-industry effects of electronic communications. Neither the credit unions nor the savings and loan associations presented their views to the Subcommittee, but several of the general problems involved would seem to be applicable to the associations at least.

1. The Branch Banking Issue. The key issue which evokes concern about competition between like institutions involves the functions which are legally permitted to be offered at a consumer terminal. As was noted earlier, an automated teller machine basically performs all the functions which are performed by a teller on the bank premises, and thus the machine provides at its geographic location an additional business location for the owner bank. The two other types of terminals appear from the testimony to be less problematic. The point of sale terminal offers the most limited function, that being in essence one of providing a cash transaction without the use of currency. The courtesy counter terminal offers types and numbers of functions somewhere between the other two types of terminals, and its effects raise different but significant issues.

The invention and use of ATMs create new dimensions in the practices of banking. As a result, new issues are raised respecting the regulation of the locations where banking services are offered. These issues involve questions of federal law and of state law, and present some complications in attempts by state governments to regulate the use of EFT systems.

The regulation of banking in the United States occurs both at state and national levels. The American banking system is composed of federally chartered banks which in general are not subject to state laws, and state banks which in general are not subject to federal banking laws. There are, of course, zones of mixed influence; e.g., a state chartered bank is subject to a certain amount of federal regulation by virtue of an agreement to be insured by the federal deposit insurance corporation. By virtue of two provisions in federal law the influence of a single federally chartered bank is limited. One law prohibits a federal institution from engaging in business across state lines. Another provision limits the number and location of branches a federal bank may open within any state to those which a bank chartered in that state legally might operate pursuant to state law. Competition between federal banks and state banks thus is sought to be balanced.

In Iowa, the area of influence of a single bank is limited. Branch banking is prohibited (Code sec. 524.1201), but a state bank may establish and operate "bank offices" subject to

limitations on number and location (Code sec. 524.1202). This privilege also is extended to federal banks (Code sec. 524.1204). The effect of these limitations are that both state and federal banks in Iowa have a rather limited ability to compete with other state and federal banks in terms of location.

The apprehension expressed to the Subcommittee by some bankers is of the possibility that the customer of a bank offering electronic terminal banking will be able to go to one of its terminals, located two, three or four hundred miles or more away from the bank, and make deposits, withdrawals, loan payments, withdrawals against a line of credit (essentially the borrowing of funds), transfers of funds from one type of account to another, and even transfers from that customer's account to the account of another of the bank's customers; in short, that so-called "full-service" banking of today, and perhaps some new services as well, could be made available by a single bank located in Des Moines, or Chicago, or even New York City, to the residents of every county in the state of Iowa. This capability it is suggested would tend to drive those banks of fewer assets, and thus those offering the fewer conveniences and services, out of existence.

As a legal question the relationship of ATMs or CBCTs to the branch banking laws has received considerable judicial attention recently. On the federal level considerable controversy resulted from an interpretive ruling issued by the comptroller of the currency late in 1974.

The Supreme Court of the United States had prior to 1974 decided that the receipt of deposits and the payment of withdrawals, when done at the same location, constitutes branch banking.

The question was raised again in the federal courts following the ruling of the comptroller of the currency. In that ruling it was declared that the operation by federally chartered banks of EFT terminals located off bank premises did not constitute branch banking. The immediate impact of this ruling was felt by numerous states which at the time of that ruling did not permit branch banking. Given that ruling, federally chartered banks arguably were in a position to develop and use EFT facilities wherever the banks deemed them desirable, since if they were not branches, state law restrictions on numbers and locations would not apply.

As a matter of state law the issue is less clear, and several states have adopted the position that electronic communications systems of whatever function do not constitute branch banking. The question never has received the attention of the Iowa Supreme Court.

In response to, or at least as a result of, that ruling, many federally chartered banks began the development of EFT systems, including Iowa-Des Moines National Bank in Des Moines,

Iowa. As a result of those actions, several states including Iowa, enacted legislation in an attempt to deal with this new development in banking. A Subcommittee survey of the states indicated that several had dealt with the question prior to 1975, others acted in 1975, and still others are anticipating action in 1976.

In March of 1975, the federal district court for the District of Columbia issued an injunction against the comptroller of the currency forbidding the application of the December ruling. The conclusion of the court was that electronic terminals, at least in some cases, do constitute branches as that term is used in the federal law, and thus the federally chartered banks would have to comply with number and location restrictions found in state law. Similar suits also were brought against the comptroller in the federal courts in Missouri and Colorado. Subsequent to the March decision of the district court in the District of Columbia and an appeal of the case to the circuit court, the comptroller withdrew the December ruling. Thus at present there is no federal authority for the operation of electronic off-bank facilities to the extent that they constitute branches.

The Iowa enactment authorized the use of electronic "satellite facilities" both by state and federal banks. The Iowa law states that satellites shall not be subject to the restrictions on location or number contained in chapter 524 of the Code (chapter 240, Acts of the Sixty-sixth General Assembly, 1975 Session, section 3) and therefore as of July 1, 1976, both federal and state banks will have the authority to operate electronic facilities wherever they are deemed desirable.

The present Iowa law avoids the "branch banking" issue by eliminating its effects. This would seem to be the only practical approach as state law definitions of a "branch" would not be binding on federal institutions anyway, at least under present federal law. Several of the individuals who testified before the Subcommittee indicated that some types of EFT terminals are effectively branch banks, and suggested that restrictions similar to those applying to branch offices also should be made applicable to those types of terminals. As well be more fully discussed in the section of this Report entitled "Potential Uses and Abuses...", several individuals and organizations have proposed modifications to the existing definition of satellite facility and to the degree of regulation of the types of terminals involved.

The branch banking question remains without authoritative resolution. If federal law were to be amended to exclude all electronic terminals from the definition of branch bank, then state branching laws would have no further applicability to federal banks, unless of course the Congress were to subject in some manner federal bank electronic terminals to state law. If Congress fails to act then federal banks will continue to exercise, at least on a state by state basis, whatever privileges state banks are given.

As a final point it is noted that some commentators suggest that once the experimental stage has passed, it will be necessary for all banks to join an EFT system in order to remain competitive in the financial market. One banker suggested that any bank currently having less than 100 million dollars in assets should be concerned about potential competition from EFTS affiliated institutions.

2. Off-Premise Systems for Savings and Loan Associations. The Subcommittee received no testimony from representatives of the savings and loan industry, and thus it is unclear whether or not intra-industry competition through EFT systems causes any concern for the associations. Members of the banking industry did testify that the savings and loan industry as a whole is expanding its operations, and thus it would seem that the larger associations could achieve a superior competitive position through the use of electronic consumer terminals. A more serious and pressing problem is the competition between banks and savings and loan associations, and the issues presented there are discussed later in this Report.

3. Credit Unions and EFTS. The Subcommittee received no testimony from representatives of the credit union industry. Given the statutory limitations on membership in a credit union it seems reasonable to conclude that use of an EFT system by one credit union would not have a significant impact on the position of other credit unions.

#### Inter-industry Competition

Based upon the testimony received by the Subcommittee, the most serious potential impact of EFT systems on competition occurs between industries rather than within. Representatives of the banking industry commented that neither state nor federal savings and loan associations have specific limitations respecting the location or number of offices which may be operated. They commented further that the Federal Home Loan Bank Board which regulates the federal associations has taken the position that federal associations are relatively free to develop EFT systems as they will. Many of the banking representatives appearing before the Subcommittee expressed considerable concern that the associations through the use of electronic consumer terminals would achieve a competitive advantage over banks.

The competitive struggle between banks and savings and loan associations cannot be commented upon here at length because of the absence of substantial testimony before the Subcommittee. Nevertheless, a few observations can be made about the general nature of the two industries involved, and their functions as seen by the consumer.

Historically the distinction between a bank and a savings association has been rather significant. Based upon testimony before the Subcommittee it would appear that these historical differences slowly are being eliminated, at least at the federal level. As an example it was stated by bank representatives that

proposed federal law amendments would enable associations to offer checking-type accounts to customers. The widespread use of electronic terminals could result in even less of a distinction between the two institutions, at least in the eyes of the consumer. As shown by the Subcommittee's survey of states, several have mandated that electronic systems cannot be utilized unless made available for use by banks and savings and loan associations without discrimination. Senate File 536 contained language which has been cited as a similar restriction. As a result, the consumer-user of EFT terminals would have the choice either of maintaining funds in a non-interest bearing checking-type account with a bank, or in an interest-bearing account, when offered, at a bank or a savings and loan association. At least one Subcommittee member expressed great concern about such consumer selectivity, indicating that at present approximately 40% of bank earnings are derived from non-interest bearing funds contained in checking accounts. The potential loss of this income poses significant questions about the future profitability of banks vis-a-vis savings institutions.

Information was not presented to the Subcommittee respecting the use by credit unions of EFT systems, but some observations also can be made in that area. As was noted above, credit unions tend to be more restricted in operation because of the inherent nature of their creation and existence. Since members of a given credit union traditionally have had some common bond, such as the same employer, the number and location of offices of that credit union would have virtually no impact on the membership of other credit unions. Although not discussed by the Subcommittee, it is deemed worthy of note that changes in the law of credit unions made by Senate File 39 (Acts of the Sixty-sixth General Assembly, 1975 Session, chapter 241) permitting consolidation of unrelated groups of employees (section 4, first new subsection), permitting individuals to retain membership who no longer share the common bond (section 5), and arguably permitting the merger of an Iowa organized credit union with one organized in another state (see section 15, and compare to section 533.30, Code 1975), the use of electronic terminals by credit unions would seem to create new possibilities for growth in membership and assets.

The ultimate effects electronic consumer terminals may have on competition and the overall financial structure cannot be predicted at this point in time. Two variables remain which greatly will influence the result. One factor is the degree of consumer acceptance and use of the terminals. The Iowa superintendent of banking testified that information available to him to date fails to indicate whether or not the electronic facilities will have great consumer appeal, and be cautioned that even by February, 1976 when his report on experimental plans is required, the limited experience in this state probably will not be sufficient to permit valid predictions. The second factor is the additional limitations, if any, which the General Assembly imposes upon the use of EFT terminals. The Superintendent also suggested that the provisions of Senate File 536 probably are not adequate to

deal with the variety of systems available for use, and some members of the banking industry also favor additional restrictions. The specific recommendations are discussed later in this report.

#### THE REGULATORY AGENCIES

Another area of inquiry directed by the resolution is the interrelationships between regulatory agencies which result from EFTS legislation. State banks in Iowa are regulated, of course, by the department of banking. The Iowa chartered credit unions also are under the supervision of the department of banking. The savings and loan associations are regulated by the supervisor of savings and loans located within the office of auditor of state. Federal instrumentalities are not subject to direct regulation by the state, at least with respect to the exercise of financial and business affairs.

Ignoring the self-repealing provisions of S.F. 536, the superintendent of banking is given some regulatory authority over the use by state banks of EFT facilities (see section 10). Section 4 of that Act authorizes banks to "utilize, establish or operate satellite facilities" with savings and loan associations and credit unions. Sections 15 and 17 of that Act give to credit unions and savings and loan associations, respectively, comparable authority to utilize, establish or operate facilities with members of the other two industries. Thus each type of financial institution is empowered to contract with the other types for the purpose of operating satellite facilities.

The superintendent of banking, with respect to banks and credit unions, and the supervisor of savings and loan associations, each are given authority by the Act to regulate the agreements and practices of their respective charges. It was suggested by some persons who testified before the Subcommittee, however, that the existing structures for regulation of the financial institutions are inadequate to meet the demands of EFT systems operations. Of primary concern is the fact that some of the proposed systems involve the use of centralized computer "switching" devices and a vast network of transmission lines, none of which are subject to state regulation under the present law. In addition, section 9 of S.F. 536 authorizes non-Iowa banks to receive communications from consumer terminals located within Iowa, and it is unclear whether those banks are directly subject to the authority of the superintendent of banking under S.F. 536.

A representative of the Independent Bankers Association of America presented to the Subcommittee suggested legislation which would establish a state agency responsible for regulating the communication network involved in the transmission of EFT data. Evidence submitted by many of the persons who testified suggests that numerous persons other than presently regulated banks, savings and loan associations and credit unions probably will be involved in the receipt and transmission of EFT data, and those persons would not be directly subject to state regulation under the law as it will exist on July 1, 1976.

In addition to any potential problems caused by noninstitutional participants involved in EFT systems, there remain questions respecting the authority of the superintendent of banking over savings and loan associations, and the authority of the supervisor of savings and loan associations over banks, as that authority would relate to the use of EFT facilities. Senate File 536 gives rule-making authority to both agencies, and also enables inter-industry agreements for the use of EFT systems. The Act does not, however, clearly establish authority over inter-industry agreements and potential problems would seem to lurk in the area of mutual use of facilities.

The Subcommittee makes no findings or conclusions respecting the questions of regulation of communications systems or the interrelationship of the industries or regulatory agencies, but it would appear that these questions will need resolution in the future. As an example of the difficulties which may be encountered, it was suggested to the Subcommittee by some persons that the superintendent of banking be given the authority to issue cease and desist orders against banks failing to comply with applicable law or regulations. Conceivably a bank might have contractual obligations with savings and loan associations and other persons involving substantial investments. If there were to be inconsistent departmental rules relating to EFTs usage, the superintendent of banking could encounter substantial obstacles in attempting to enforce a cease and desist order under those circumstances. Thus, some resolution of the authority question is in order.

#### SECURITY, CONFIDENTIALITY AND DOCUMENTATION

The Subcommittee made considerable effort to discover how the existing and proposed EFT systems in Iowa would provide for the security of account holders' funds, for the confidentiality of account information, and for the identification and documentation of EFT transactions.

##### Security

One of the primary questions about electronic systems for the storage and transfer of wealth is how well do these systems protect against undesirable activity. Security problems vary depending upon the type of terminal being used.

In the instance of an automated teller machine, actual cash may be dispensed, thereby creating the need for protection of the machine itself against unlawful entry, and for protection of potential users of the machine, particularly if it is located outside of secured premises, or is available for operation outside of normal business hours.

In the case of courtesy counter terminals, the need for physical security exists, and in addition the need arises to protect account holders against possible misuse of account information by employees of the business enterprise which houses the terminal and provides operating personnel.

The representatives of Banks of Iowa who demonstrated actual EFT system equipment described the use of one system component which provides some security. Through the use of this device, the Subcommittee was informed, the customer is able to actuate, or prevent, transactions on his or her account. The system provides an identification number which is not a part of the electronic account number, and which is known only to the customer and bank personnel. In order for a courtesy counter terminal to effect a transaction the customer is required to insert this number into the electronic process by means of a keyboard device which is concealed from the view of everyone but the customer. In this manner, persons who have no reason to engage in transactions without the presence and consent of the account holder are prevented from having unobserved access to that account.

Point of sale terminals would seem to offer fewer security problems in that the proposed method of operation would be a transfer of funds from one account (the buyer), to that of another person (the merchant). Presumably the buyer would receive a receipt of a sale transaction which would function as a safeguard against certain potential misuses.

Discussion to this point has neglected the electronically coded account card which literally is the key to system use. Resembling in size and features a credit card of modern use, this device is designed to provide specific information to the electronic terminal, and also is designed to prevent alteration. The loss of a credit card has resulted in recent years in the passage of legislation in most states to limit the liability of the cardholder in case a lost card is misused by the person finding it. Senate File 536 contained an analogous provision which limits the liability of an account holder and assumes that the account holder would not incur loss in excess of fifty dollars.

Although these statutory provisions ultimately tend to protect the cardholder, the system in general must account for any losses resulting from misused transaction cards. Present Iowa criminal law relating to the misuse of "credit cards" (section 713.39) was not designed to cover the EFT system device, and arguably would not apply to a transaction card which permits only "debits" or transfers between accounts. Some consideration should be given to amending that Code section and related sections.

The presence of criminal penalties may or may not deter unauthorized use of transaction cards, and assuming that prevention is a less costly alternative, the device described above for securing courtesy counter terminal transactions would seem to merit use in any terminal transaction, whatever the type, where personal identification is not an absolute prerequisite to the acceptance of a card by the operator of a terminal.

Another aspect of security which perhaps accounts for much of the impetus for the use of electronic transactions is the security provided against misuse of account privileges by account holders themselves. The representative of Hy Vee Stores, Inc., who testified before the Subcommittee suggested that much of that corporation's interest in electronic transactions stems from the relatively large amount of money lost each year through the acceptance of checks which are not paid because of insufficient account funds and similar causes. Any EFT system, to the extent that it provides immediate communication with the account holder's electronic account, eliminates the possibility of overdrafts and the resultant expense involved in collection, even assuming that collection is practicable and fruitful.

A more complex area involving security concerns those individuals who are employed by the corporation or other entity which manufactures or operates the central computer equipment used in those systems where more than one institution is involved. A proposed system such as that to be shared in by the Davenport Bank and Trust Company involves many banks located in five different states. Operation of such a complex system involves the use of a central switching center which connects the various terminals to the appropriate receiving banks upon demand. Needless to say, the central unit places certain individuals in a position to have at least theoretical access to every account serviced by the system.

Written testimony presented to the Subcommittee emphasized the many hazards of the computerized storage and transmission of information, and pointed to some of the difficulties involved in securing a vast telecommunications network. It was recommended that several steps be taken to tighten the security required for EFT systems used in Iowa. These recommendations are listed later in this report.

#### Confidentiality

The confidentiality of a consumer's electronic account is protected to some extent by the security provisions adopted by the bank and other agencies involved in the process. However, an additional concern was presented by one Subcommittee member, that of the confidentiality of the habits and practices of individual account holders which could be determined from computer records of an individual's transactions.

The president of the Iowa-Des Moines National Bank explained that one of the goals of its currently operating experimental system is to assess the needs and demands of consumers based upon various social factors, such as geographic location of residency and income level. Development and expansion of any system could result in the storage of information about where and when an individual or a coded set of individuals are most likely to spend their funds, thereby enabling, e.g., marketing analysts with

access to that information to develop "personalized" sales campaigns. Mr. Bob Krane, the president of Iowa-Des Moines National Bank, indicated that their proposed uses of such information likely would demand confidentiality in order to protect the business interests of the bank.

Written testimony raised questions about the undesirable dissemination of such information by bank or central computer employees, and other persons having unauthorized access to computerized data. It also noted the potential civil liability of a bank to one of its customers whose personal data was wrongfully disseminated.

Suggestions for legislation to reduce problems in this area also were received by the Subcommittee and are noted later in this report.

#### Documentation

Somewhat conflicting purposes arise in the area of the documentation of EFTS transactions. One of the stated benefits of an electronic system is the ability to dispense with a considerable portion of the paperwork which now characterizes transactions with or through a financial institution. It was stated that a card holder will be given a receipt identifying each transaction, and the computer will make continuous printed records of each transaction, but that all of the intermediate documentation now burdening the system will be eliminated.

Section eleven of House File 536 provides that permanent records of terminal initiated transactions must be maintained by a utilizing bank for the period for which other account records are required to be maintained. That section also provides that a written record shall be provided by a bank to any party to a terminal initiated transaction, although the section is unclear as to whether the requirement would be satisfied by providing a single receipt at the time of the transaction.

Documentation is also significant in the instance of the point of sale terminal. Since the transactions encountered in this area involve rights and liabilities between the consumer and the merchant or other person operating the facility, there is a need for adequate information on the transaction receipt. This is an issue which can be resolved by the owners and operators of POS terminals, but adequate information must be recorded for use in future disputes. It is not known at this time if legislation is necessary to secure the availability of necessary documentation.

The reverse side of the documentation question was raised in the written memorandum of the Independent Bankers Association of America presented to the Subcommittee. One of the problems cited therein is the potentiality that a person who has access to the computer memory banks could effect a removal of funds on deposit in an account without any documentation whatever. This raises the

question of the account holders liability in cases of loss. Of particular note are the potential legal questions involved when persons other than the bank are involved in the transaction. S.F. 536 fails to indicate who bears the risk, e.g., in the instance of a robbery of a customer convenience counter if a customer has made a deposit, but the funds had not been transported to the bank at the time of the robbery. Although S.F. 536 does provide account holder protection in some circumstances, other conceivable circumstances do pose unanswered questions.

An additional question involves the amount of time needed to clarify or resolve consumer problems with or at terminals. A question was posed to the representatives of the Banks of Iowa System of how a card holder would obtain satisfaction if, for example, he or she attempted to make a transaction at a courtesy counter terminal, but the system failed to complete the transaction. Because of the absence of bank personnel at the convenience facility, it was determined that the account holder would be required to appear at the bank if the problem could not be resolved at the convenience terminal. This problem was cited in the IBAA memorandum referred to above, and it was noted that the more distant the location of the terminal from the bank or residence of the account holder, the more time consuming or difficult would be adjustments to accounts.

#### POTENTIAL USES AND ABUSES OF OWNERSHIP, AGREEMENT AND PRACTICES

The bulk of Subcommittee time was spent in attempting to obtain specific answers to questions involving the ownership, use and financial aspects of EFT operations. Given that all of the presently proposed Iowa systems are in very preliminary stages of development, the most sought after answers could not be given, except in terms either of speculation or prediction.

#### Costs of Electronic Systems

Perhaps the most critical question is what will be the financial costs of operating electronic convenience facilities. Estimates of cost are very difficult to make because of the nearly limitless variety of structures which might be employed. Nearly everyone who testified suggested that an individual financial institution could not afford to maintain its own independent system. In addition, the representative of Hy Vee Stores stated that, at least in metropolitan areas, a terminal which communicated with only one bank likely would not be acceptable to a merchant-service to only one institution would not convenience a large enough portion of the merchants' customers or offer POS services suited to the needs of the merchant. Thus, for practical purposes as well as financial ones, it would seem that a system would have to involve several institutions.

1. Cost to each institution.

A shared system raises the obvious question of what the

A shared system raises the obvious question of what the owner of that system will exact from others who use it. House File 536 allegedly requires shared usage facilities, and mandates that a using bank may not be charged more than a pro-rata portion of system costs plus a "reasonable return" to the owner of the facilities. Neither "pro-rata" nor "reasonable" are defined in that Act, and the terms probably are open to broad and varied interpretations.

Mr. Bob Brenton of Brenton Banks suggested that each bank desiring to join their system might be required to pay an initial fee of from 3,000 to 5,000 dollars plus a periodic charge based upon the number of transactions. In addition it was suggested that a charge of one dollar would be imposed for each card issued. Mr. Brenton stated that the various banks either would use certain existing equipment or would obtain necessary receiving devices. Thus, for that system the cost would vary depending upon the sophistication of existing equipment owned by a bank.

Mr. James Figge, of Davenport Bank and Trust, indicated that the central owner of their equipment, Financial Communications Corporation, would buy all of the necessary equipment and thus the costs to each bank would be determined by the overall system cost. He estimated that the entire cost of the proposed system, including statewide operations between and among five states could amount to as much as 35 million dollars. Mr. Figge stated that the cost to an institution for joining the FCC charge would be approximately 800 dollars per one million dollars of bank assets contained within checking accounts or demand savings accounts.

## 2. Costs to consumer.

Whatever the cost to a financial institution, the real costs of this convenience will be borne by the customers of that institution. If widespread acceptance of the systems by consumers becomes a reality, then probably the charge to each customer would be relatively low. This assumes that the use of EFT facilities replaces to a great extent, the use of checks by the consumer. Subsection two (2) of section four (4) of S.F. 536 prohibits a bank from increasing the costs of check-writing services in order to force customers into electronic transactions, and prohibits a bank from compelling customers to accept EFT in lieu of check writing. Thus, in the near future it would not seem likely that demand for electronic transactions will greatly outweigh the desire for checking account services. To the extent that the consumer continues to write checks for the bulk of his or her transactions there seems little likelihood that a cost savings, or even a cost equivalency will be seen by the consumer. In this vein it is noted that many industry spokesmen suggest that the consumer will not eagerly accept the loss of float time (the time consumed between the writing of a check and its eventual debiting from the consumer's account).

## 3. Costs to merchants.

Some controversy exists about whether or not merchants will pay a fee to offer EFT terminal service to their customers. Some bank representatives suggested that EFT will result in a cost savings to merchants and thus they will be required to share some of the costs of operation. Some merchants, however, see EFT as little more than a "banking" convenience to their customers and for that reason suggest that merchants will not agree to pay a charge for terminal operations. As something of a middle ground, some persons suggest that courtesy counter terminals will not be charged to merchants, but that point of sale terminals, in that they represent savings to the merchant through a reduction of bad check losses, will be installed and operated only for a fee.

A collateral issue raised in these discussions is whether or not a merchant can anticipate enhanced revenues and a competitive advantage as a result of the presence of convenience terminals on the premises. Some commentators have remarked that EFT terminals will not be placed in low customer volume establishments because the predicted usage would not justify the cost. As a result, those businesses having high customer volume would be the only sites selected for terminal installation, and some predict that the smaller businesses will lose even more customers to the chain operated businesses. One banking representative suggested, however, that in time any business with a telephone line would be able to participate in a system.

#### Area of Usage

A significant question which has been referred to earlier in this Report is to what extent EFT systems should be used by a bank outside of its own locality, county, or even state. As noted in the discussion of competitive aspects of EFT systems, many of the bankers of Iowa, as represented by the Iowa Independent Bankers Association, express concern about the extent to which metropolitan banks may extend their services into the more rural areas.

Representatives of Davenport Bank and Trust, on the other hand, suggest that metropolitan banks have customers outside their geographic confines, and further that those customers carry their banking needs across county and even state lines, particularly those who are residents in border communities. They suggest that extra-county and even extra-state communication of electronic transactions are consistent with the modern habits and needs of consumers.

#### Differentiation of Function

As indicated, members of the banking community are not in agreement about "extra-territorial" operations of a financial institution via an EFT system, and one substantial issue is the availability of the deposit function outside the usual trade area. The depositing of funds appears to be the key type of transaction which would enable a financial institution to extend appreciably

its area of influence. Thus, it is suggested, if a financial institution were prohibited from accepting deposits by way of electronic transfers at any location except its immediate trade area, the competitive advantage of, e.g., the metropolitan bank, would be eliminated.

The Iowa Independent Bankers have recommended that the deposit function with respect to each bank be limited to that area comprised of the county in which the bank is located, and to contiguous counties. Further, they recommend that non-Iowa institutions be prohibited from doing any business in this state via an EFT system. They recommend that section 9 of chapter 240 of the Code be repealed to effect this latter purpose.

#### REGULATION OF EFT SYSTEMS

The wherewithal of EFT systems control are the powers of the state and the regulatory agencies to prevent abuses by the owners of systems and financial institutions and other persons utilizing and operating those systems.

An unresolved legal question is the degree to which a state may regulate, and this authority is limited by the fact that some banks and savings and loan institutions are federally chartered. Individual states have no direct authority over federal institutions, and the amount of indirect control also is rather limited. Attempts were made in S.F. 536 indirectly to regulate federal institutions by (1) placing certain restrictions on Iowa residents who act with or on behalf of those institutions, and (2) to condition the deposit of public funds in those institutions upon the "voluntary" compliance of those institutions with Iowa EFT system laws.

Some commentators have questioned the effectiveness of these provisions, particularly with respect to savings and loan associations. It is urged that the laws of Iowa cannot prohibit a federally chartered savings and loan association from purchasing or leasing space for the installation of EFT equipment. If this be the fact, then placing restrictions on other institutions potentially could give the associations a competitive advantage over banks and perhaps credit unions.

#### Assessment of Existing Law

One of the goals of the Subcommittee was to determine if present Iowa law, including chapter 240 of the Acts of the Sixty-sixth General Assembly, is adequate to cope with the proposed uses of electronic funds transfer systems. The superintendent of banking, Mr. Thomas Huston, was asked to testify about the adequacies and deficiencies of present law. Mr. Huston indicated that, in general, until the required February, 1976 report by his department has been prepared the department could not make any specific comments about the status of Iowa law. He suggested that present law probably is inadequate to handle all of the new

problems to be incurred as a result of EFT system ownership and operation.

During discussions of the law, several features are deemed worthy of comment, even in the absence of specific proposals. The comments, suggestions and observations are summarized in question form as follows:

1. Does the existing definition of "satellite facility" recognize the variety of facilities and the potential variations in legislative treatment of each?
2. Are limitations needed with respect to numbers and locations of terminals, or at least ATMs and possibly customer convenience counter terminals?
3. Are measures desirable which would prevent out-of-state financial institutions from engaging in EFT communications in Iowa?
4. Are permanent provisions needed to regulate merchants and other non-institutional operators of EFT terminals?
5. Should non-institutional operators of EFT terminals be licensed and bonded?
6. Should provisions in S.F. 536 which require the removal of public funds from federal institutions failing to comply with Iowa law and regulations be made permanent?
7. Should the superintendent of banking or other state officer be given the authority to issue cease and desist orders against institutions in violation of law or departmental rule?
8. Should the state license and regulate transmission lines and other equipment used in EFT systems?
9. Should EFT systems generally be regulated as a public utility?
10. Do the regulatory agencies need more specific rule-making authority?
11. Should owners of central computer centers be licensed and bonded?
12. Should non-institutional operators of EFT terminals be required by law to hold customers harmless against loss?
13. Should account holders be given special civil causes of action for unauthorized disclosure of computerized data?
14. Should mobile EFT terminals be permitted?
15. Should the statute be more specific as to rates and charges imposed upon account holders and terminal operators?

16. Do present criminal fraud laws need revision in view of the "non-credit" nature of electronic transaction cards?

17. Should the departmental approval of locations of EFT terminals be subject to hearing under the Iowa administrative procedure act?

18. Should civil penalties be provided for violations by regulated institutions? Other persons?

19. Are new criminal provisions needed to define crimes and establish penalties which relate to unauthorized use of or interference with EFT systems?

20. Are the use of intra-industry rule-making powers by existing regulatory agencies consistent with inter-industry use of facilities?

21. Should some state agency be given authority to regulate non-institutional owners and/or operators of EFT facilities?

22. Should regulatory agencies be given the authority to regulate the physical locations of EFT terminals and to prescribe security measures, etc.?

#### Report on Experimental Phase

The 1975 legislation contained the requirement that the superintendent of banking submit to the General Assembly in February of 1976, a report of the operations of authorized experimental systems, including findings and recommendations respecting the potential uses of "satellite facilities" in Iowa. At its December 1 meeting the Subcommittee inquired of the superintendent of banking about the February report. Mr. Huston stated that a report will be submitted, but that it may have limited significance. Mr. Huston indicated that only the Iowa-Des Moines National Bank system will have been in operation by that date, and he expressed doubt that the information obtained from only one experiment would have substantial value.

The Subcommittee noted some of the significant questions which have arisen respecting EFT systems, and asked that Mr. Huston include in the report a discussion of the following matters:

1. The federal court decisions entered on the various lawsuits filed against the comptroller of the currency and the federal financial institutions, and the effects of these decisions on the operation of EFT systems by federally chartered instrumentalities.

2. An analysis of Iowa law in terms of whether or not proposed electronic terminal usage constitutes "branch banking".

3. The potential impact of EFT systems on the state of Iowa and its financial institutions, including the relative competitive positions of banks of various asset size.

4. The concerns of the department about the effects of EFT systems, whether or not the department submits accompanying conclusions or recommendations.

5. The concerns formally or informally expressed to the department by the various bankers or other financial institutions in Iowa, and the conclusions of the department respecting those concerns.

#### Conclusion

This Report does not attempt to answer the multitude of questions raised by testimony before the Subcommittee. Although costly, electronic funds transfer systems appear to have the qualified acceptance of the financial industry and some representatives of the retail business industry. Present evidence does not indicate whether or not EFT systems ultimately will represent cost savings to the system as a whole.

The Subcommittee makes no findings or recommendations with respect to EFT systems in Iowa, but generally it can be stated that some legislation, at least corrective in nature, is warranted in order to accurately reflect the nature of the systems being used.

Respectfully submitted,

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Chairperson