

BUSINESS DAY

Regulators Turn Spotlight on Cybermoney

By SAUL HANSELL SEPT. 19, 1996



As concerns grow about electronic money laundering, cybercounterfeiting and bank runs on the Internet, regulators in the United States and around the world are scurrying to catch up with the rapid development of electronic money.

Treasury Secretary Robert E. Rubin plans to announce today two initiatives intended to grapple with the new technology. United States regulators will look at consumer protection issues raised by new technologies, like smart cards that store electronic money for making small purchases. In another move, an international group of regulators, under the auspices of the Group of Seven industrialized countries, will examine the international cooperation needed as money moves through the borderless world of the Internet.

"We are concerned about the use of electronic transfer of value for cross-border money laundering or cross-border tax evasion," Mr. Rubin said in an interview yesterday. In addition, he said countries would have to sort out which laws apply to electronic transactions.

"If someone in Washington buys something over the Internet from someone in London, where on the wire under the Atlantic did the transaction take place?" Mr. Rubin asked.

The creation of two committees of regulators demonstrates that government recognizes that action will eventually be needed on electronic transactions. Still, given the complex international issues involved, it will take years to reach a consensus. And some experts say that there is little that regulators can now do.

"It is so questionable now what form all this will take, that the Government couldn't regulate it if it tried," said Anita Boomstein, a lawyer who specializes in consumer payment issues at Hughes Hubbard & Reed in New York. "So the Government will take a hands-off attitude until it gets so big it is an entire system of money and the Federal Reserve will need to be in control."

Mr. Rubin will announce the regulators' panels in a speech beginning a two-day conference in Washington today. The conference, sponsored by the Treasury Department, will bring together senior officials ranging from Alan Greenspan, chairman of the Federal Reserve, to John S. Reed, chairman of Citicorp.

"The electronic transfer of value will be enormously important with respect to how economies function in the years and decades ahead," Mr. Rubin said. "Since we deal with money, finance and banking, our goal was to get ahead of the curve."

There have been a handful of tests of various forms of electronic money. Smart cards, with money stored on them, were introduced by three big banks at the Olympic Games in Atlanta, and a similar system is set for testing early next year on the Upper West Side of Manhattan.

A small but growing number of purchases are being made over the Internet, mainly by using credit cards. But Mark Twain Bank of St. Louis has introduced an electronic cash product, developed by Digicash of the Netherlands, in which money is actually stored on the disk drives of users' computers.

These early moves have already forced some regulators to confront how the new technology fits into existing regulations. The Federal Deposit Insurance Corporation has decided that money stored on smart cards does not count as federally insured deposits. That means if the card is lost, there is no guaranteed refund. (Some companies, like American Express, are developing stored-value cards that do offer refunds if lost, as with traveler's checks.)

Moreover, there is now no requirement that a company that issues stored-value cards must be a bank or regulated in any other way. That raises the question of whether these cards will become as unruly as the market for prepaid telephone cards, in which a number of card vendors have failed to deliver the calls that were promised.

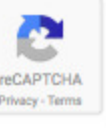
"The prepaid phone card market is a good example of how consumers can be left holding the bag," said Sharon P. Sivertsen, director of the office of policy development for the F.D.I.C.

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To prevent such problems, a number of other countries have decided to require that stored-value cards only be issued by banks.

The Federal Reserve has issued proposals on whether the consumer protections guaranteed for other electronic money transfers -- like direct deposits and debit cards -- will apply to stored-value card purchases. These protections include the requirement of receipts with every purchase and a limit on liability if a card is lost or stolen.

The Fed has proposed that card systems that cannot hold more than \$100 and those that have no central records of how much money is on each card be exempt from the strict consumer protection rules.

"The Fed proposal is destroying consumer protection," said Janice C. Shields, the consumer research director for the U.S. Public Interest Research Group in Washington. "They don't want to disclose error resolution procedures, and they want unlimited consumer losses."

Ms. Shields has proposed that issuers be required to list information about what to do in case of problems and disclosures about fees and liability of losses on the back of each card and at locations that sell or accept the card.

The \$100 limit may have a particular cost for consumers, she added. "It's a fee bonanza for the banks because you will have to load the card more often an pay a fee every time," she said.

The Smart Card Forum, an industry group, by contrast, says the Fed exemptions do not go far enough and the stored-value products are so new that they should not be regulated.

The new technology raises a range of other issues that regulators expect to confront the next few years. The effectiveness of computer security measures, for example, has the Government of two minds. On one hand, regulators concerned with consumer protection and with the safety and soundness of banks want to insure that security is as strict as possible. Yet law enforcement agencies are frightened by the anonymity such systems grant potential criminals.



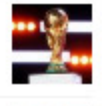
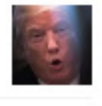
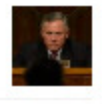





It is unclear, how fast these electronic money systems will move into mainstream use. Banking by computer, for example, languished for nearly a decade until the last year, when nearly a million people signed up for a new batch of services.

One force pushing the development of the technology, however, is the Government itself, which has mandated that all payments to or from Government accounts must be made electronically by 1999. This may have the most significant effect on the recipients of various welfare programs, many whom now do not have bank accounts that could receive an electronic money transfer. To deal with this, various groups of state governments are developing special cards on which benefits payments will be stored. Recipients will be able to use the cards to withdraw cash at automated teller machines and to make purchases.

One of the thorniest issues is whether holders of these welfare cards get the same protections as holders of credit and debit cards issued by banks. State and local governments do not want to absorb the cost of issuing refunds, for example, though some readings of the electronic funds transfer act would require that they do.

Some are also concerned that as banks move more toward offering their services electronically, they will have more reason to close branches in inner-city areas.

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