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Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, NW
Washington, D.C. 20551

Re: Docket No.: R-1176
Amendments to Regulation CC
The Check 21 Act

The American Bankers Association ("ABA") is pleased to submit our comments to the Federal Reserve Board's ("Board") proposed amendments to Regulation CC and its Commentary to implement the Check Clearing for the 21st Century Act (Check 21 Act) published in the January 8, 2004 *Federal Register.* We applaud the Board and its staff for their efforts in developing and promoting the legislation. We also compliment them on the proposed regulations, which we generally strongly support. This letter supplements another letter ABA is submitting jointly with a number of other organizations that identifies and discusses significant issues.

The ABA brings together all elements of the banking community to represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

229.2 (aaa) Definition: Sufficient Copy

The Board proposes to define "sufficient copy" as "a copy of an original check that accurately represents all of the information on the front and back of that check as of the time it was truncated or that otherwise is sufficient to determine the validity of the relevant claim." We agree with this proposed definition and believe that the term "sufficient" should be used rather than the Check 21 Act's term "better." A "sufficient" copy is more accurate and appropriate under the circumstances: a sufficient copy is all that is necessary; a "better" one may not ever be achievable and is not necessary.

Section 229.31(a)(2): Encoding of Qualified Return Check

The Board has proposed removing the "second-to-last sentence of Section 229.31(a)(2)(iii)" and inserting another sentence in its place.

However, subpart (iii) only contains a single phrase and the second-to-last sentence of the remainder of part (a)(2) reads:

> The time for expeditious return under the forward-collection test, and the deadline for return under the UCC and Regulation J are extended by one business day if the returning bank converts a returned check to a qualified returned check.

We believe that the Board intended to replace the third-to-last sentence in Section 229.31(a)(2) as it is related to the replacement sentence.

Section 229.54: Expedited Recredit For Consumers.

(a) Circumstances giving rise to a claim.

The proposed Commentary makes clear that a consumer may only make a claim for expedited recredit for a substitute check if he or she has actually received a substitute check. It further explains that a consumer that received only an image statement containing an image of a substitute check would not be entitled to make an expedited recredit claim. These statements are consistent with the Check 21 Act and should be made clear in the Regulation and Commentary. Accordingly, we recommend that they be retained.

(b) Procedures for making a claim.

(3) Form and submission of claim; computation of time.

With regard to the expedited recrediting provisions, the Check 21 Act measures time from the "business day" of receipt of the claim. The Board proposes in the Commentary to use "banking day," which would be consistent with the rest of the Regulation. Banking day is any day the office of a bank is open to the public for carrying on substantially all of its banking functions. Business day means a calendar day other than Saturday and Sunday and official holidays.

We agree that it makes more sense to use "banking day" rather than "business day" because it will only be on banking days that the part of the bank responsible for investigating the claim will be open. To start earlier would deprive banks of important time to investigate.

The proposed Commentary also explains that the consumer must provide the reason why the original check or sufficient copy is necessary to determine the validity of the claim. It continues with examples, including the example that if the consumer believes that his or her signature has been forged, the original check might be necessary to confirm the forgery, if, for example, pen pressure or similar analysis were necessary to determine the genuineness of the signature.

We suggest that the Board omit the examples. They are not necessary. Moreover, the example of the pen pressure will simply give license to allow anyone to make a claim, regardless of the merits. Banks today manage claims of forged signatures based on images when the original check is no longer available, and we do not believe that there have been problems. Including the explicit example in the Commentary will compel banks to store virtually all checks, at great expense, to protect themselves against false claims that rely on a simple assertion that pen pressure analysis is necessary. This will defeat an important objective of the Check 21 Act.

Finally, the example is not practical. Pen pressure analysis is rare, occurring only when an original check survives that involves a large dollar amount and when other analysis is unavailable or inconclusive. A rare event is not an appropriate example.

If the Board retains a reference, it should also state: "The bank may consider other factors in evaluating or denying a claim if the consumer claims that pen pressure or similar analysis is necessary to determine the genuineness of the signature."

(c) Action on claims.

The Board lays out four potential responses to a consumer's claim: valid consumer claim; invalid consumer claim; recredit pending investigation; and reversal of credit. We believe that this format provides a logical flow and structure and is more straightforward and understandable than the statutory one. Accordingly, we recommend that it be retained.

The Board has also requested comment on whether interest credit should be reversed if the recredit is reversed. While the statute does not specifically provide for it, this only makes sense. There is no reason for a consumer to gain from an invalid claim.

Appendix D

The Board proposes to make the name and location on the depositary bank indorsement optional. Today, it is mandatory. We believe that the name and address of the depositary bank are necessary in the indorsement and should be required. The check's return will be delayed if the routing number is illegible and no bank name or address is available.

The Board is also proposing to require that all indorsements be printed in black ink. Currently depositary bank indorsements must be printed in dark purple or black ink and other indorsements in an ink color

other than purple. We agree with the proposal. Purple was appropriate before image was adopted because it expedited check returns by highlighting the bank to whom the check would be returned. However, purple is often too light to be legible on images. Black ink will ensure the greatest clarity and legibility of the indorsements.

The Board has requested comment on what benefits, if any, there would be in providing returning banks with the flexibility to indorse on the front of checks and to include additional information on their indorsements. While allowing indorsements on the front may reduce clutter on the back, it will also hinder review and analysis of important information on the front of the check. For example, if indorsements are permitted on the front, alternations and forged signatures will be harder to detect. Also, the indorsements will interfere with fraud prevention tools such as those used to detect differences in check pattern stock. Moreover, as a practical matter, most systems currently in use are not set up to review the front of the check for indorsements.

Remotely-created Demand Drafts

The Board has requested comment on whether it would be appropriate to incorporate U.C.C. amendments relating to demand drafts into Regulation CC. ABA strongly supports this concept and recommends that the Board immediately issue proposed rules in this area. We urge the Board to pattern the provisions after amendments already adopted in at least thirteen states rather than the wording developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 2002.

The approach used by the thirteen states is preferable for several reasons. The demand draft amendments enacted by the states have been tried and tested. Bankers in those states have not reported any problem with the wording. Indeed, several ABA members tell us that the provisions have worked effectively to address the “demand draft” problem. Various clearinghouse rules also use the demand draft approach.

In contrast, our information indicates that no state has enacted the NCCUSL “remotely-created consumer item” amendments. Although it has been reported that Minnesota adopted the NCCUSL amendments in 2003, the actual statutory language was modified in this area to address some of the banking industry’s concerns. These changes include deletion of the consumer account limitation and addition of a facsimile provision (see Chapter 81, S.F. No. 28, 2003 Session). Several state legislatures have rejected the NCCUSL proposal. Significantly, forty-two state bankers associations are on record as opposing the NCCUSL approach and supporting the demand draft type amendments enacted in several states.

Another reason the state demand draft amendments are preferable is because of their broader scope. Unlike the NCCUSL approach, the

state demand draft provisions are not limited to drafts drawn on consumer accounts. ABA supports a broader application that includes drafts drawn on business accounts. As one bank attorney noted, it is more likely that a fraudster would use a commercial account to perpetuate a fraud since there is typically not an insufficient funds problem. Imposing the consumer account limitation would mean that demand drafts drawn on non-consumer accounts would not be covered by the new warranty provisions, thus leaving this area open to fraudulent abuse.

Such a limitation would also create needless operational problems. For example, it would be difficult in some cases to identify whether an item was drawn on a consumer account. The following comments from a bank attorney highlight the potential problem:

> When the depository bank receives the item and sends it through for collection, it might want to know whether that item is going to be subject to the payor bank's midnight deadline or not. And it is certainly going to want to know this if the item is indeed returned to the depositary bank after the midnight deadline. Should it accept the return of the item, or reject it? How will it know if the item was drawn on a consumer account?

ABA also feels strongly that the Board should include wording in Regulation CC that is consistent with demand draft language used in the states. Two areas come immediately to mind. First, almost all demand draft statutes include an exception for items drawn by a fiduciary. Second, the warranty in the demand draft statutes generally applies to all terms on the face of the draft -- not just the amount of the item. Such provisions were unfortunately not included in the NCCUSL amendments. Without such provisions, additional preemption and interpretation questions will arise.

Handling demand drafts has been a widespread problem for our members. ABA supports a change in the transfer and presentment warranties and would appreciate the opportunity to provide additional input on the best approach. We urge the Board to issue a proposed regulation for comment as soon as possible.

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ABA appreciates the opportunity to comment on this important issue and commends the Board staff for their efforts.

Sincerely,

Nessa Eileen Feddis