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Ms. Jennifer J. Johnson
Secretary,
Board of Governors
of the Federal Reserve System
20th Street and Constitutions Avenue, NW
Washington DC 20551

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Docket No R-R-1409
RIN NO. 7100-AD68
Regulation CC
Expedited Funds Availability Act
76 *Federal Register* 16862 (March 25, 2011)

Dear Ms. Johnson,

The American Bankers Association[1] (ABA) is pleased to submit our comments on the Federal Reserve Board's (Board) proposed changes to Regulation CC, which implements the Expedited Funds Availability Act. ABA commends the Board for its thoughtful effort to update the regulation to remove obsolete definitions and provisions to reflect changes in the check processing system and to promote a more efficient check processing system by facilitating electronic check processing. While we support the proposal in general, some provisions will need further consideration and study to address practical issues, electronic item exchange standards, and other important issues. In addition, we urge the Board, in revising the regulation, to balance the goals of bank customers' quick access to their money, customer understanding of when funds are available, the risk of fraud, and the costs and technical challenges related to compliance.

Among other suggestions, we recommend that the Board—

- Recognize and address treatment of electronically-created items, including payor-created electronic remotely created checks, to provide a framework on which to build agreements and clearing house rules so that such products may evolve;

- Review comments and conduct further study with regard to same-day settlement before re-proposing a same-day settlement solution because of confusion about the intent and meaning of the same-day presentment proposal, the lack of standards that would promote agreements among paying and presentment banks, and the potential unintended consequences;

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets.

- Shorten the period during which exception holds are presumed to be reasonable from seven to five days, rather than to four days as proposed, to reduce the potential for banks and their customers to become victims of fraud;

- Improve the disclosures and notices as proposed, but ensure flexibility in formatting and paper size so banks may communicate effectively and customers will understand clearly when they have access to their funds; and

- Omit burdensome, costly, and technically challenging requirements that provide benefit to at most a small percentage of customers, such as the requirement to provide electronic hold notices.

SUBPART A – GENERAL

229.2 (s) Electronic collection item.

The proposal introduces a new term, "electronic collection item," which it defines as an electronic image of and information related to a check that a bank sends for forward collection and that a paying bank has agreed to receive under Section 226.36(a) and that is sufficient to create a substitute check. Generally, we agree with the addition of the new term, but we are concerned that depositary banks and other banks in the check processing chain other than the presenting bank cannot know whether the paying bank has agreed to receive electronic collection items, which would thus not be subject to the warranties. The final rule could provide that, if the banks exchanging the item have agreed to exchange electronic collection items, then, between those parties, the item would be an electronic collection item subject to the warranties.

229.2 (u) Electronic presentment point.

The proposal defines electronic presentment point as the electronic location that the paying bank has "designated" for receiving electronic collection items. This point may be either an e-mail address or other electronic address. Publicly providing an e-mail address is not industry practice because of security and fraud considerations. We suggest deletion of the reference to e-mail to avoid inferences that it is an industry practice or acceptable under Regulation CC.

SUBPART B – AVAILABILITY OF FUNDS AND DISCLOSURE OF FUNDS AVAILABILITY POLICIES

229.12(d) Deposits at nonproprietary ATMs.

The Board proposes to reduce the current maximum hold period for nonproprietary ATM deposits from 5 business days to 4 business days on the basis that it is reasonable to expect that a check cleared and returned entirely in electronic form would complete the roundtrip in 3 business days. The Board requests comment on whether the funds availability schedule's distinction between deposits to proprietary ATMs and deposits to nonproprietary ATMs continues to make sense in an environment where all in-person cash deposits and check deposits must be made available for withdrawal by the second business day following deposit. We recommend that the Board retain the distinction, since not all ATM deposits will be "all-electronic." There remain many ATMs that do not convert check deposits to images and situations where the ATM deposits are not converted at the point of deposit.

229.13 – Exceptions.

13(g) – Notice of exception.

Total amount of deposit. Based on consumer testing, the Board proposes to require that the notice of an exception hold contain the total amount of the deposits, in addition to the amount of the deposit being held, which is currently required. It found that during consumer testing, consumers were more readily able to recall the deposited check for which the funds were being held when the notice included the total amount of the deposit rather than only the amount being held. The model forms reflect these proposed changes.

While many banks already provide the total amount of the deposit on the hold notice, some are not able to provide it in all instances, for example, if the customer is not present when the hold is placed. If the hold is placed sometime later in the check process when the check has been disconnected from the other checks in the deposit, some banks lack the "line of sight" back to the original deposit to be able to reconstruct the total amount. These banks will incur substantial costs to modify or redesign their systems to be able to determine and disclose on the notice the total amount deposited.

We appreciate that in theory providing the total amount of the deposit on the exception notice might help some customers, for example, those who make multiple deposits in a day or split the deposit (that is, take some portion of the deposit in cash and deposit the remainder). However, as a practical matter, any advantage is limited. First, the primary concern of customers is the length of the hold and the amount of funds being held, not the total amount of the deposit. The Board's testing found that some participants incorrectly identified the total amount of the deposit, but it provided no explanation of how knowing the total amount deposited assists customers in understanding or reacting to the hold if they understand the amount of the hold. If there is an issue or question, customers typically contact the bank for further information. Second, although consumer testing might have shown that some customers struggle to identify or recall an imaginary total deposit amount, people are more likely to remember and identify a real deposit on which they are depending. Accordingly, the conclusions of the testing are limited. Finally, we are not aware of any complaints that customers do not understand their hold notices based on actual experience.

Given the substantial costs for some banks and limited benefit for customers, we recommend that the Board not require that the hold notice include the amount of the deposit. Instead, it could include the total amount of deposit in model disclosures as an option, which would encourage banks to provide the information.

Electronic notices. The Board is proposing that for notices not provided in person, if a customer has agreed to accept notices electronically, the depositary bank is required to send the notice so that customers may expect to receive it no later than the first business day following the day the deposit is made or the facts become known to the depositary bank, whichever is later. For example, the bank could e-mail notice. In effect, the Board is requiring that notices be sent electronically if the customer has "agreed to accept notices electronically." The Board requests comment on whether providing a notice in this fashion is feasible

ABA understands the goal of alerting customers as soon as possible that a hold has been placed on their deposit so that they may ensure that there are sufficient funds available to cover their payment instructions that were given based on the availability of the funds from the deposit. However, we strongly recommend that the Board not adopt this provision, as providing electronic hold notices is not currently operationally feasible or cost-effective.

While some banks have indicated a preference for sending electronic hold notices rather than mailing paper ones, we have not been able to identify any bank, including those offering "all electronic" accounts, that actually do so. Indeed, generally, they are not able to provide electronically many non-pre-programmable notices such as hold notices. Unlike periodic statements or low-balance alerts, for example, hold notices cannot be scheduled or programmed in advance. They are often manual rather than automated decisions made at different points in the collection process (e.g., at the branch or in the back office). The notices must contain event-specific information rather than a general notice applicable to all recipients. Directing that confidential, personalized notices subject to strict compliance requirements be sent electronically, privately, and securely from various points where the hold decision may be made is not feasible as a practical matter using current programs. Even if a general e-mail message could be transmitted directing customers to their account on the website, which today is the most secure means of transmitting the information, posting individualized notices is not practical and presents significant technical challenges.

Even if a system of providing hold notices electronically were practical or feasible, it would not be cost-effective given the low volume of notices that are sent. The requirement would only apply to a relatively small number of notices because: (1) the number of holds represents a small percentage of the total number of deposits; and (2) the electronic delivery requirement would only apply to those not receiving a notice in person, and of those, only those who have agreed to accept notices electronically. Moreover, it would require maintaining dual systems for a relatively low volume of notices, which, again, is not cost-effective given the limited benefits. We add that there are few if any complaints about the timing of the notices.

Finally, while the meaning of "agreed to accept notices electronically" is not clear, the regulation could be read to mandate that if the bank allows customers to receive ***any*** notice electronically, it must provide hold notices electronically. Thus, even if a bank's only electronic communication is notice that an account statement is now available online, which is the extent of many banks' electronic capabilities, for example, it must provide hold notices electronically. The underlying assumption is that the Board -- and any other agency -- by regulation ***may insist*** that businesses transmit certain or ***all*** communications electronically to customers who agree to electronic communication. This approach contrasts with the Electronic Signature in Global and National Commerce Act which ensured electronic communications were legally valid and enforceable but did not compel their use. Banks, like other businesses and government agencies, should have the flexibility to determine what information will be sent electronically based on numerous factors including: technological feasibility; privacy; security; customer preferences; costs; volume; legal considerations; and suitability and effectiveness of alternative channels. Indeed, the Board itself recognized this when, on November 9, 2007, it specifically rejected requiring e-mail notices under Regulation DD, which implements the Truth in Savings Act, noting concerns about data security, identify theft, and phishing, and fears that consumers might ignore or delete e-mails to avoid falling victim to fraud schemes.[2] The Board's discussion of this decision demonstrates how any electronic communication method may become inappropriate. Further, mandating that the hold notice be provided if the customer has agreed to electronic receipt of any notice will discourage or limit electronic communications generally, even though beneficial to customer and bank alike.

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[2] See http://edocket.access.gpo.gov/2007/pdf/E7-21701.pdf pp. 63841, 63842.

Given that providing the electronic notice electronically is not feasible as a practical matter, and even if it were, it is not cost-effective given the limited benefit and low volume of notices involved, the cost, and compliance risks, we strongly recommend that the Board permit, but not mandate, that hold notices be provided electronically to customers who have agreed to accept electronic notices.

229.13(h) Exceptions -- Availability of deposits subject to exceptions.

Currently, funds from a deposit subject to a hold must be available within a reasonable period. It is assumed that a total of seven business days is reasonable.[3] The Board proposes that the safe harbor for the reasonable hold extension for a deposit of on-us checks remain one business day and that the safe harbor for the reasonable hold extension for other checks be reduced to a total of four business days for all other checks. The Board believes that the reduction is appropriate as it anticipates virtually all returned checks to be returned by the third business day after the day of deposit. In addition, it provides an incentive for depositary banks to take advantage of electronic check-return infrastructure.

We agree that it is appropriate to reduce the holds if collection and return times are shortened. However, it is also critical that holds be sufficient so that banks have a reasonable chance to learn of the return of a check subject to an exception—and therefore more risky by nature – before the bank is required by law to release the funds. Otherwise, the regulation will simply give criminals an additional tool to perpetrate fraud on banks and their customers but provide only marginal benefit.

A frustratingly persistent common fraud scheme, the fake check and wire scheme, illustrates the fraud risk. Under these schemes, fraudsters send bank customers counterfeit checks, typically appearing to be cashiers' checks, based on some kind of lure, such as the criminal's purchase of something the victim is selling on the internet or notice that the victim has won the lottery. A reason is given for there to be excess funds, e.g., overpayment, lottery taxes owed. The victim is directed to deposit the check and withdraw cash as soon as permitted by law, which, for cashiers' checks, is the day after deposit. The criminal then instructs the victim to wire immediately the excess funds. The check is later returned unpaid, and the victimized customer is liable for the amount wired. Currently, these schemes tend to be just under $5,000 because fraudsters know the first $5,000 of cashiers' checks must be available on the day after deposit and before the bank can learn the check is unpayable.[4] If the regulation shortens the safe harbor exception hold period so that criminals have a reasonably good chance that an ***unlimited*** amount of money must be available for withdrawal before the bank can learn the check is unpayable, they will be emboldened to increase the amount of the fraud significantly above the current $4,000 to $4,999 they attempt today.

Given that shortening the hold periods makes check fraud more lucrative and attractive to criminals, the Board should be cautious when balancing customer convenience with the potential for both banks and their customers to become victims of fraud. In addition, the Board may always shorten the exception hold period in the future, if appropriate, but shortening it significantly today and then lengthening it later is more difficult.

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3 The regulation provides that a seven day hold is reasonable for local checks and an eleven-day hold is reasonable for nonlocal checks. However, nonlocal checks no longer exist because there is remains a single check processing region.

4 The Dodd-Frank Wall Street Reform Act increased certain dollar amounts in the Expedited Funds Availability Act to adjust for inflation since its passage n 1987, but declined to do so for the large dollar exception (except for inflationary adjustments going forward) so as not to increase or promote this type of fraudulent activity.

Based on data on check return times gathered from members of all sizes, ABA believes that five days rather than the proposed four is an appropriate safe harbor for exception hold periods. In order for funds to be available on the morning of the fourth day as proposed, checks would have to be returned within three days since returns arrive after the time funds must be available.

Several banks of different sizes reported to ABA the percentage and amounts of checks that were returned between the fourth and seventh day (the current period assumed to be reasonable). Some also provided information on the increase in losses during that period. Based on the survey, if funds on exception items were available on the fourth business day after deposit rather than the seventh business day—

- The average percentage of the number of checks that would not return before funds would have to be released would increase 18.16 percent, representing a 21.10 percent increase in the dollar amount returned.

- The average number of items on which there would be a loss if funds would have to be released by the fourth business day would increase 32.34 percent, representing a 34.55 percent increase in the dollar amount of losses.

However, if the funds on exception items were available on the fifth business day after deposit rather than the fourth business day, the percentage and amounts of returns and losses decreases appreciably:

- The average percentage of the number of checks that would not return before the funds would have to be released would increase 8.39 (vs. 18.16) percent, representing a 9.78 (vs. 21.10) percent increase in the dollar amount returned.

- The average number of items on which there was a loss if funds were released on the fifth business day would increase 16.78 (vs. 32.34 percent), representing a 15.69 (vs.34.55) percent increase in the dollar amount of losses.

Exception Hold Timeframe Reduction Impact Analysis

	Lag in Business Day	4	5	6	Total (day 4–day 6)	Total (day 5–day 6)
Percentage of Total*	Returned Items #	9.77%	5.37%	3.01%	18.16%	8.39%
	Returned Items $	11.32%	8.67%	1.11%	21.10%	9.78%
	Returned Item Losses #	15.56%	12.32%	4.46%	32.34%	16.78%
	Returned Item Losses $	18.86%	13.81%	1.87%	34.55%	15.69%

*The percentages are unweighted averages of the percentages reported by banks.

It appears that the reason the forward and return process is not as fast as the Board might presume may in part be due to the intermediaries involved in the forward collection process. In addition, the data provide some suggestion that unpaid items may be manipulated to lengthen the collection and return process to cause late returns.

Given the volume and value of checks that will not return within the proposed four-day exception hold period, the increased exposure to fraud for both banks and their customers, as well as the incentive for criminals to take advantage of the greater fraud opportunities, the regulation should adopt five days as the safe harbor for the exception hold period. We believe that this is a more appropriate balance between customers' quick access to funds and fraud prevention. If the time needed for checks to return to the depositary banks decreases, the Board may always revisit and shorten the period if appropriate. However, the data at this time do not support the proposed change.

229.16– Specific availability policy disclosures.

16(c)(2)—Longer delays on a case-by-case basis: Notice at time of case-by-case delay.

` This section sets forth the information required in a notice when a bank invokes a case-by-case hold. Case-by-case holds are exceptions to a bank's general availability schedule and are invoked when the bank has a reason to delay release of funds beyond its usual schedule, but none of the statutory exceptions apply. The information in the case-by-case hold notice is similar to that required for exception hold notices and must include the total amount of deposit and the specific date on which funds will be made available.

The Board requests comment on the extent to which banks continue to find it useful to apply case-by-case holds in the absence of nonlocal checks, and whether it should be deleted. We strongly encourage the Board to retain case-by-case holds. Most banks make deposits available *sooner* than required by law, that is, the business day after deposit rather than the second business day after deposit, but they wisely retain the option to provide a case-by-case hold in the event there is a legitimate reason to place a hold but for which no statutory exception applies. Accordingly, these case-by-case holds permit banks to adopt generally shorter schedules than required by law and also help to minimize losses. For example, they allow banks an extra day during which time they may obtain information that justifies a longer exception hold. If case-by-case holds are eliminated, banks will have an incentive to move from next-day availability to second-day availability policies. Fundamentally, there is no systemic problem with the actual use of case-by-case holds that warrants eliminating a bank's discretion to apply a hold in circumstances where it finds them appropriate.

As with the exception holds, the proposal requires the case-by-case hold notices to include the amount of the deposit and to be provided in a manner that the customer will learn of the hold not later than the first business day following the banking day of deposit (e.g., by e-mail) if the customer has agreed to accept notices electronically. See our comments to Section 229.13(g) on exception hold notices with regard to inclusion of the total amount of deposit in the hold notice and with regard to electronic delivery of hold notices.

Appendix C –

Model availability-policy disclosures clauses and notices.

Paper-size disclosure design. While the regulation does not require banks to use a certain paper size for disclosures and notices, the model policy disclosures are generally designed to be printed on an 8 ½ by 11 inch sheet of paper with black text on a white background to increase readability. The proposed Commentary notes that a bank that provides a disclosure or notice electronically would comport with formatting specification by providing them in a file format, such as a .pdf file format that electronically represents an 8 ½ by 11 inch sheet of paper with black text and a white background. The bank may vary font size. However, a small font might not comply with the clear and conspicuous requirements.

We do not support designing the disclosures to 8 ½ by 11 inch sheets of paper or promoting this page size alone, as this paper size and format is often less effective for communication purposes than others and is cumbersome for both the customer and the bank. While the proposal does not mandate use of 8 ½ by 11 inch sheets of paper, any bank not using them loses the safe harbor and will have to defend against an examiner uncomfortable with notices on paper of a different size or make more emphatic that the paper size is a suggestion and that banks retain flexibility in determining the suitable size.

Most banks, when disclosing their funds availability policies, do not provide the various Regulation CC items (general funds availability policy, various exceptions, substitute checks) piecemeal on separate pages as in the proposed models, but integrate them into a single disclosure. They will often choose user-friendly, more slender paper brochures that make it easy for customers to identify the subject, read, and carry. Many banks will also integrate the Regulation CC disclosures into a brochure that contains additional regulatory, contractual, and other useful information. This means the customer has all account information in one convenient spot and in a convenient, easy-to-carry brochure. Electronic disclosures are also designed to be printed in user-friendly fashion that formats and integrates information so it is easier to understand and to use as a reference. Providing various and numerous 8 ½ by 11 pages simply creates more unnecessary, bulky paper and will perpetuate the criticism that bank account "agreements" are too lengthy, criticisms often based simply on the number of pages.

Providing the hold notices on 8 ½ by 11 inch sheets of paper is particularly unsuitable given the shortness of the information involved (less than a half of a page, double-spaced in the proposed model forms) and when and how the notices are delivered to the customer. It is important that customers receive hold notices as early as practical, which is at the time of deposit. Many teller stations terminals and some ATMs can print the short hold notice in a very readable fashion, but the forms are smaller than an 8 ½ by 11 sheet of paper, because the notice is short, and because of printer capability limitations. To use the longer paper as suggested in the proposal, the teller would have to step away to a special printer, slowing the transaction. If the printer is unavailable, the notice would have to be mailed, delaying notification to the customer. Providing a hold notice at the ATM would no longer be possible. Instead, the notice would have to be mailed, delaying notification to the customer.

The regulation should not promote use of 8 ½ by 11 inch sheets for either the funds availability policy disclosures or the hold notices by designing around that paper size or incorporating that suggestion into the Commentary. Rather the Board should make clear that banks have flexibility in the paper size of disclosures as other sizes may be more user-friendly. The Board should also consider and accommodate the practical aspects of providing hold notices at the teller window and ATM, so that customers learn more quickly about a hold.

Tabular format. The Board proposes to modify the format of the model disclosures from a mostly narrative form to a more tabular form. We generally agree with this approach for the funds availability policy disclosures, as the tabular format is easier for customers to understand, given the amount of information relayed. However, we do not believe that it is necessarily appropriate for hold notices. While the proposal does not mandate use of the tables, any bank not using them loses the safe harbor and will have to defend against an examiner uncomfortable with notices that do not use the tabular format. As noted above, the hold notices are short and contain only a few critical elements, so a table is not necessary. In addition, printers at teller stations and ATMs seldom can accommodate tabular format. To be practical and encourage banks to provide notices at the teller window and ATM, the regulation should provide non-tabular models for hold notices.

Charge back after making funds from check deposits available.

The proposal incorporates into the model language a statement, "If you withdraw funds from a check deposit, and the check is later returned unpaid, we may charge the check back to your account." The Board requests comment on whether this proposed revision reflects the practice of most banks.

We strongly recommend that the Board incorporate information about the customers' responsibility for returned checks into the model language of funds availability policies. In addition, we recommend modifications to the language as discussed below.

As described in our comments to Section 229.13(h), criminals take advantage of the requirement that banks must allow customers to withdraw funds before the bank can learn that the deposited check is not payable. The victims assume and the fraudsters encourage them to assume that if the bank has allowed them to withdraw the funds from the deposit, the check must be valid. This perception gives victims more confidence in the criminal, so they are more likely to participate and follow the criminal's instructions. In addition, including a warning in the notice will provide one more source and reference for customers to learn of or confirm their potential liability.

We are not aware of any bank that does not hold customers responsible for returned checks. Depositors are in the best position to understand the facts and circumstances of the transaction and the reliability of the person providing the check. They are also in the best legal and practical position to be able to recover from the maker of the check or resolve any issue: the bank may have no legal or other relationship with the maker of the check. Accordingly, liability for returned checks generally rests with the depositor.

We recommend that the model language provide that the customer "will" rather than "may" be liable in these circumstances. With rare exceptions, depositors ***will*** be liable for returned checks. In addition, those vulnerable to such scams will find comfort in the word "may" that they will not be liable, as the criminal undoubtedly will encourage. In addition, we recommend that the language be more explicit and state that just because the bank has allowed the customer to withdraw money from the deposited check does not mean that the check is good. We realize that brevity is an important goal, but this additional message is critical. We suggest the following:

> If you withdraw funds from a check deposit, and the check is later returned unpaid, we will charge the check back to your account and you will be liable for any funds from the check you have withdrawn. Because we have allowed you to withdraw the funds does not mean that the deposited check is good.

We agree that the notice should be at the top of the funds availability disclosure as proposed. Customers are more likely to read it.

Reference to day of availability.

The Board is proposing in many cases to use in the model forms “2” in place of “second,” on the basis that consumers more quickly understand. The Board also proposes that disclosures refer to the “next” business day rather than the “first” business day. However, use of ordinal numbers (e.g., second day after deposit) would continue to be permitted. We agree with these changes that promote understandability, but retain flexibility.

Model C-1 – next day availability.

Proposed model C-1 may be used by a bank with a policy of making funds available by the first business day after deposit, but not reserving the right to invoke exceptions. The Board requests comment on whether any banks have such a policy and whether this model should be deleted. We are not aware of any bank that does not reserve the right to invoke exceptions.

SUBPART C – COLLECTION OF CHECKS

229.30 Paying bank’s responsibility for return of checks.

30 (a) Expeditious return of checks.

(a)(1)

The Board is proposing to replace the current “expeditious-return” rule to promote electronic check clearing. Paying banks are required to return checks in an “expeditious manner” to reduce the risk that the check will be returned after the depositary bank has released the funds. A paying bank that does not return checks in an expeditious manner may be liable for any loss if funds are no longer in the account to which the check is returned to the depositary bank.

Currently, if a paying bank determines not to pay a check, it must return the check in an “expeditious manner,” as provided under one of two tests, the two-day/four-day test or the forward collection test. To meet the “two-day/four-day test,” a paying bank must return a local check so that that normally the depositary bank would receive it no later than 4 PM on the second business day. For nonlocal checks, the check would normally have to be received by the fourth business day. The “forward” collection” test is satisfied if a paying bank sends the returned check in a manner that a similarly situated bank should send a check of similar amount, drawn on the depositary bank, and deposited for forward collection by noon on the banking day following the banking day on which the check was presented to the paying bank.

Generally, we agree with the proposal as it provides an appropriate incentive for banks to return items electronically, increasing the likelihood that the depositary bank will not release funds before the item is returned. However, we have concerns about how a paying bank determines whether the depositary bank has agreed to electronic return and is therefore entitled to expeditious return.

Proposed comment 5 provides examples of where the depositary bank has agreed to accept electronic returns. Under the second example, a paying bank has agreed to accept electronic returns from a returning bank which holds itself out as willing to accept electronic returns directly and has agreed to handle returns expeditiously. However, a depositary bank could agree to accept electronic returns only from a returning bank with limited connections to paying banks and no connection to an image exchange network. It is not practical for the paying bank to determine with which returning bank the depositary bank has an agreement for electronic return. Therefore, we suggest that the returning bank have an actual agreement with the paying bank and is not just "holding itself out" as willing to accept electronic returns. In addition, a depositary bank could be deemed to have an agreement for electronic return if it has an agreement for expeditious return though the Federal Reserve System, whether or not the paying bank has an agreement with the Federal Reserve.

229.30(d) Identification of a returned check.

Refer to maker reason for return.

The proposal provides that "refer to maker" is insufficient as a reason for return, because "refer to maker" is an instruction to the recipient of the return check and not a reason for return (e.g., insufficient funds). Refer to maker could be provided in addition to the reason for the return.

ABA strongly opposes elimination of the instruction "refer to maker" as a substitute for the reason for return. There are valid reasons for a "catch-all" such as refer to maker:

- Banks avoid potential legal claims against the bank and other difficulties if the return reason is suspected fraud, the payee asserts fraud against the payor, and the item is not in fact fraudulent;
- The check does not match the corporate customer's positive customer pay file and the customer wants the check recipient to notify him rather than document a reason, especially if the reason is suspected fraud;
- Accord and settlement has been added to the indorsement; and
- Some state laws require banks to instruct payees to refer to them, the maker.

Moreover, it is our understanding that most return reasons fall within the list of coded reasons, but it is not practical to create an automated system that contains every conceivable reason for return. If "refer to maker" is not permitted, another catch-all will need to be adopted.

In the past, there may have been some overuse of "refer to maker," for example, in the case of a duplicate, but we believe that any such problem has been resolved. Unless the Board is aware of some kind of abuse, complaint, or other problem that cannot otherwise be addressed, we strongly encourage retention of "refer to maker" in lieu of the actual reason.

229.30(e) – Notice in lieu of return.

Currently, if a check is unavailable for return, the paying bank may instead place a copy of the front and back of the returned check, or if no such copy is available, a written notice of nonpayment containing information specified in current 229.33(b). Given the availability of check images, the Board proposes to amend the regulation to provide that a bank may send a notice in lieu of return only where neither the check itself nor an image of and information related to the check sufficient to create a substitute check is available. The Commentary will provide that if no image of both sides of the check is available, the notice in lieu of return may be sent by means of an electronic transmission, so long as it contains required information, e.g., by Automated Clearing House (ACH) record or by electronic check record.

The Board requests comment on whether a bank would ever have the information necessary for a notice in lieu of return if it had neither the check nor an image of both sides of the check and whether the notice in lieu provision should be deleted. ABA recommends that the Board retain the notice in lieu of return, as it will continue to have utility. For example, there are times when the image is unretrievable or insufficient to create an electronic return.

Currently a notice in lieu is not required to contain the MICR line. However, banks can often use the data from the original MICR line to find in its computer systems an image of the item and which the bank can either re-clear or charge back to its customer's account. Because the MICR helps depositary banks identify the item involved, ABA agrees that the information-content specifications for a notice in lieu of return should be modified to reflect these capabilities by requiring that notice in lieu of return include the check's original MICR line.

ABA does not support processing notices in lieu through the ACH system. Check and ACH systems are often separate, and there is the potential risk that the notices will not reach the appropriate department.

229.32 – Depositary bank's responsibility for returned checks.

32(a) – Acceptance of electronic returns.

The Board proposes three different circumstances under which a depositary bank would be deemed to have agreed to accept an electronic return:

1. Direct contractual relationship with the paying bank;
2. Direct contractual relationship with a returning bank (e.g. returning bank holds itself out as willing to accept electronic returns by publishing information about its generally available electronic return service);
3. Other agreement with the paying bank to receive an electronic return (e.g., where both are members of the same clearing house).

Comment 4 to Section 229.32(a) provides that if a depositary bank designates an e-mail address as its electronic return point, the depositary bank has received the electronic return when it is delivered to that e-mail address, suggesting that an e-mail address is an appropriate location for return. As discussed in our comments to 229.2(u), definition of electronic presentment point, publicly providing an e-mail address is not industry practice. We suggest the reference be deleted to avoid inferences that it is industry practice or acceptable under Regulation CC.

229.34 – Warranties and indemnities.

34(e) – Electronic image and information transferred as an electronic collection item or electronic return. (Electronic items not derived from checks).

The Board proposes to address instances when an electronic image of a "check" is created, but a check never existed in paper ("electronically-created items"). In effect, the Board is proposing to treat such items as electronic collection items and electronic returns for purposes of the warranties.

Currently, electronically-created items cannot be used to create a substitute check. In addition, as a practical matter, a bank receiving an electronically-created item cannot distinguish the item from any other image of a check that it receives electronically. The bank may nonetheless transfer the image as if it were an electronic collection item or electronic return, or produce a paper item that is indistinguishable from a substitute check.

In order to protect a bank from potential liability that receives an electronically-created item from another bank, the Board proposes that any bank transferring an electronically-created image and related information as either an electronic collection item or an electronic return would make any warranty the bank would make if the electronically created items were in fact an electronic collection item or an electronic return. These include warranties that the image accurately represents the front and back of the original check at the time it was truncated etc, and that it is not a duplicate. The Board also has proposed that the existing warranties related to remotely created checks (including the warranty that the transaction was authorized by the account holder) be extended to electronically-created items that resemble images of remotely create checks. The Board has requested comment on whether, in addition to the proposed warranties discussed above, it should in the future consider making an electronically-created item subject to subpart C of Regulation CC as if it were a check (e.g., subject to the expeditious-return requirement).

We are aware of two potential electronically-created "check" products. The first involves electronic remotely-created checks created by payees, (electronic RCCs), which do not include items bearing a signature or purporting to bear a signature applied by the payor. The second involves payor-created electronic items.

The first check product, the electronic RCC, unofficially appears to be in use. It involves making electronic a long established system in which the payee creates a paper draft based on the payor's authorization. Insurance companies, for example, have traditionally used paper RCCs to allow customers to pay monthly premiums without having to initiate the payment themselves. Currently, payees using these systems do and are supposed to create a paper draft, scan it for remote capture and electronic deposit, and then shred the paper draft. From a practical aspect, this process is unnecessarily cumbersome and more expensive than creating an electronic check.

For many RCCs, both paper and electronic, the ACH processing is an option, but there are exceptions. For example, some payee customers are simply comfortable with the check and check image system and do not want the inconvenience of changing their system. The check image may also contain additional information that is not transmittable through the ACH. Also, there may be some accounts that do not permit ACH transactions. Some routing and transit numbers cannot be routed through the ACH. Our understanding is that NACHA rules have in the past inhibited use of recurring ACH transactions in some situations, but that those rules will change in September, and as a result many but not all RCC users may convert to ACH.

Currently, under Regulation CC, in addition to the warranties that the image is accurate and sufficient to create a substitute check and that it is not a duplicate, the depositary bank warrants the paper RCC is authorized by the account holder on which the check is drawn. This, in effect, puts the liability on the depositary bank in the event of a loss. The proposal applies all these warranties to electronic RCCs.

We agree that it makes sense, as proposed, for the depositary bank to make the warranties and to be liable in the event of a loss. First, the depositary bank is the gateway for the item and in the best position to implement controls and manage risk. Second, the regulation should recognize the evolution of the check system and promote electronic check processing and innovation. For that same reason, we recommend that that these items also be subject to Subpart C, including the expeditious return requirements. Addressing the treatment of electronic RCC in Regulation CC helps provide the beginnings of a framework on which to build agreements and clearing house rules which could lead to eventual acceptance and use.

There is some concern that recognition under Regulation CC will encourage use of electronic RCCs notwithstanding the fact that they may not be permitted by contract or clearing house rules and that various potential fraud and regulatory risks may not have been addressed. However, we believe that those concerns can be addressed through clearinghouse rules, agreements, and check standards.

The second type of electronically created items, as far as we know, is not yet in use. In this scheme, payors, with or without the knowledge or approval of their bank, would download an application which would allow them to create electronic checks, which they would send to the payee. Payees might either print the item for deposit, or, pursuant to an agreement with their bank, use remote deposit capture to deposit electronically. Concerns about this scheme are that neither the paying bank nor the depositary bank may be aware of or be able to ensure fraud controls are in place and that vendors selling such products might not be sensitive to fraud or may not incorporate controls to protect against fraud. Several years ago, a similar product was offered by a nonbank without appropriate controls. It allowed people to create a check image using MICR information and send the image electronically to the payee who printed and then deposited the check. The product attracted fraudsters who used bank customers' MICR information without authorization and led to significant check fraud losses before the FDIC warned banks not to accept such checks, and the Federal Trade Commission brought suit to order its practices halted.

There is some division in opinion about how these electronic payor-created items should be treated. Some are concerned that explicitly recognizing them in the regulation, even though they are not currently permitted under check processing rules and agreements, would encourage their use without first addressing the associated risks related to fraud and compliance. Others feel that these electronic payor-created items are a potentially valuable product for bank customers, but that they cannot evolve absent at least some rules or guidance on how they will be treated under Regulation CC with regard to warranties and liability in the event of a loss.

Arguably, it may make sense for the depositary bank to make the warranties, at least when such items are deposited through remote deposit capture, for example, because the depositary bank is in the position to control who is eligible to use remote deposit capture and how it is used. It is less clear whether a depositary bank should have to make warranties if the electronic payor-created item is printed and then deposited, because the depositary bank cannot know its creator or its electronic origins, and it is the paying bank's customer choosing to use an electronically created item. Further, if the payor's bank actually provides the product, it would seem the paying bank should have some responsibility and liability.

Because such a product has not yet materialized, and it is not clear whether the paying bank or depositary bank will be in the best position to control for fraud, if the Board applies the warranties and Subpart C to electronic payor-created items, it should limit their application to such items that are deposited by remote deposit capture and provided by third party vendors. In addition, because of past experiences with fraud from products from third-party vendors, as described above, paying banks should have the ability not to accept electronic payor-created items derived from third-party vendors, and the regulation should require that such vendors alert potential customers that they should confirm with their bank that it accepts them.

229.35 Indorsements

35(a) Indorsement standards

Proposed comment 8 to this section suggests that depositary banks may include e-mail addresses in their indorsements, which might be interpreted as an industry or recommended practice. However, current standards do not include e-mail addresses in indorsements, nor is there space. Including an e-mail address in the indorsement will require significant time and costs. We recommend deletion of this provision to avoid confusion or suggestions that it must be included.

229.36 – Presentment and issuance of checks.

36 (d) Same-day settlement.

To encourage the banking industry's ongoing transition to fully-electronic interbank check clearing, the proposal allows a paying bank to require checks presented for same-day settlement to be presented electronically as "electronic collection items" if the paying bank and presenting bank have agreed. The Board explains that allowing paying banks to receive all interbank check presentments electronically will help to streamline back-office operations and eliminate costs associated with processing paper-check presentment.

Specifically, the proposed regulation provides that a paying bank may require that checks presented for same-day settlement be presented electronically to a designated electronic present point if "it has agreed to receive the electronic collection item -- (i) directly from the presenting bank; or (ii) as otherwise agreed with the presenting bank. The proposed Commentary clarifies that a paying bank may have "otherwise" agreed with the presenting bank if both the presenting bank and paying bank are members of the same clearing house, under the rules of which the paying bank has agreed to accept electronic collection items from the presenting bank. Further, the proposed Commentary provides that the presenting bank must deliver the electronic collection item to the electronic location designated by the paying bank and that the paying bank's agreement with the presenting bank must designate an electronic presentment point.

The industry supports the goal of all-electronic check presentment at some future time. However, the proposal is premature as there are differing views on how to achieve all-electronic payment, different interpretations about the meaning and intent of the proposal, and concern about unintended consequences.

First, it is not clear the meaning of "it [the paying bank] agreed to receive the electronic collection item directly from the presenting bank." "Directly" appears to modify "receive" rather than "agreed," raising the question, with whom is the presenting bank agreeing? If it is an agreement between the paying bank and the presenting bank, then what must the agreement cover beyond designation of the electronic presentment point?

Even if we assume that under the proposal the agreement must be a direct one between the paying bank and the presenting bank or an indirect one through clearing house agreements, for example, it is not clear what happens absent an agreement between the paying bank and presenting bank. In that situation, it appears that under paragraph (d)(2), the presenting bank may not present paper for same-day settlement but may be forced to present to the paying bank's designated electronic presentment point for same day settlement, even if that means paying a fee to present to the Federal Reserve Board if that is the paying bank's designated electronic presentment point.

Some banks, from the perspective of presenting bank, do not want to have to pay to present electronically for same-day settlement, just as today they do not pay for same-day settlement for presentment of paper. They are willing to have agreements with paying banks. However, other banks, from the paying bank perspective, are reluctant to adopt multiple standards, formats, and presentment points, and they prefer a single electronic presentment point, the Federal Reserve Board. They feel that the paying bank should have some control over how and where they accept electronic collection items and should not necessarily be required to modify their systems or to retrieve electronic collection items for the convenience of the presenting bank. They also do not believe that they should pay to accept items electronically.

Given the confusion about the intent and meaning of the same-day presentment proposal, the lack of standards that would promote agreements among banks, and the potential unintended consequences, we suggest that the Board review comments and conduct further study before re-proposing an all electronic presentment solution.

Effective date.

The Board proposes that subparts A and B take effect 30 days after publication and that banks have 12 months to comply with subpart B. It proposes that amendments to subparts C and D "become effective" six months after publication of the final rule, that is banks would have to comply six months after adoption. Banks could continue to present paper checks under the terms of the U.C.C. and Regulation J.

Whether 12 months is sufficient to comply with subpart B will depend on the contents of the final rule. For example, if the amount of the deposit must be included in hold notices, if hold notices must be provided electronically, or if banks have to make all the suggested formatting and paper size changes to hold notices, banks will need up to two years to comply. Six months is sufficient for Subpart C unless, for example, "refer to maker" is no longer acceptable as a substitute for the reason for the return or indorsements must include e-mails.

Conclusion.

ABA appreciates the Board's thoughtful work and effort to modernize Regulation CC to reflect changes in the check collection system and to promote electronic check processing. We agree with the proposal in general, but we believe that some proposed provisions require further study. In addition, we ask that the Board balance consumer interests in quick access to their deposits with the risk of fraud and the costs and challenges of compliance. We are happy to provide further information.

Regards,

Nessa Eileen Feddis