



1120 Connecticut Avenue, NW  
Washington, DC 20036

1-800-BANKERS  
[www.aba.com](http://www.aba.com)

*World-Class Solutions,  
Leadership & Advocacy  
Since 1875*

**Nessa Feddis**  
Senior Federal Counsel  
Phone: 202 663 5433  
[Nfeddis@aba.com](mailto:Nfeddis@aba.com)

***By electronic delivery***

3 May 2005

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20 and C Streets, NW  
Washington, D.C. 20051

Re: Proposed amendments  
Regulations J and CC  
Docket No. R-1226  
70 *Federal Register* 10509, 4 March 2005

The American Bankers Association (“ABA”) is pleased to submit its comments to the Federal Reserve Board’s (“Board”) proposal to amend Regulation CC, which implements the Expedited Funds Availability Act, to establish rules governing remotely created checks. The proposed amendments would shift liability for unauthorized remotely created checks from the paying bank to the depositary bank. The Board is also proposing conforming cross-references to the proposed new warranties in Regulation J.

The American Bankers Association, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best 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.

ABA commends the Board’s initiative to address problems related to unauthorized remotely created checks and supports the general concept underlying the proposal. We do, however, offer suggested modifications to the proposed language.

***Background***

Remotely created checks are generally checks that bear a statement that the customer has authorized the check or bears the customer’s printed name in place of an actual signature. They are frequently used for legitimate transactions, for example, to pay a bill by telephone. However, they are more vulnerable to fraud than checks

bearing signatures because the paying bank lacks the opportunity to compare a signature on the remotely created check with one on file. Because the paying bank cannot learn that the check is unauthorized until the customer notifies them, long after the midnight deadline by which the paying bank must return items, the paying bank usually suffers the loss.

Dishonest people have taken advantage of this vulnerability associated with the paying bank's lack of opportunity to compare signatures by paying bills by phone or internet, using another person's legitimate account number without authorization. The criminals use both consumer and business account numbers. The fraudulent items are typically for modest amounts to pay phone bills, though they are also used to pay larger bills, such as those for credit card accounts. As a percentage of check fraud losses, the losses associated with remotely created checks are relatively small, but that percentage appears to be increasing. The proposal attempts to assist banks in addressing this fraud by shifting the risk associated with remotely created checks from the paying bank to the depository bank.

***Definition of remotely created check.***

***General approach.*** The Board's proposal defines "remotely created check" as a "check that is drawn on a customer account at a bank, is created by the payee, and does not bear a signature in the format agreed to by the paying bank and the customer."

In its 11 March 2004 letter on proposed changes to Regulation CC, ABA had recommended that the Board pursue the approach adopted by a number of states, such as California, rather than that of the Uniform Commercial Code ("UCC") as revised in 2002. First, the UCC language excludes checks drawn on commercial accounts. Second, the language used in state laws has been tested and generally proven to be workable. The successful application of the state law approach could mean avoiding uncertainties and challenges associated with adoption of dissimilar language.

Nevertheless, if the Board feels that it is necessary to modify the demand draft definition adopted by numerous states to take into account changes in the payment systems environment since its original adoption, we suggest several changes to the Board's proposed definition.

***Creators of remotely created checks.*** First, the Board should change "created by the payee" and in its place insert "not created by the paying bank." It is not relevant who created the check, and the paying bank cannot know who created it. Today, remotely created checks may be created by someone other than the payee. For example, a vendor providing a bill paying service may send an unsigned check on behalf of the customer. We believe that because there is no signature to compare

in these cases, the paying bank should enjoy the benefits of the proposed rule.

However, there are situations where the paying bank creates an unsigned check, to which the proposed warranties should not apply. For example, a paying bank might create a check pursuant to an online bill payment program. In many cases, under online banking programs, the payments are sent electronically. However, where this is not an option, the paying bank creates a draft. We do not believe that these items should be covered. While these drafts also lack a signature, the paying bank, as the creator, is in a better position than the depository bank to determine whether they are authorized. Accordingly, we suggest that the final rule clarify that the definition excludes checks created by the paying bank.

***“Format agreed to by the paying bank and customer.”*** Second, we suggest that the Board delete “in the format agreed to by the paying bank and the customer.” We appreciate and agree with the Board’s intent to avoid interpretations that the warranties apply to machine-applied signatures and potentially to agreed to printed signatures. However, we think this language is too broad and will create confusion. For example, it could be interpreted to allow application of the warranties to valid signatures that are not in the exact format as agreed, e.g. Joanne Smith instead of Joanne J. Smith. We believe that concerns about legitimate agreed to types of signatures such as machine-applied signatures could be addressed in the Commentary through clarification of the meaning of “signature.”

***Signature requirement.*** We also do not believe that it is necessary to add to the word signature, the qualification “purporting to be the signature of the customer.” Whether a signature is purported to be that of the customer or of someone else is irrelevant. *At this time*, our members are only seeking to shift the risk as the Board proposes for items that lack a signature – any signature. If the check bears a signature that is purported to be that of someone other than the customer, the paying bank still has the opportunity to determine whether there is a valid signature. In the future, ABA’s members may wish to expand application of the proposed warranties, but at this time, we suggest it be limited.

The Board expresses concern that a creator of a draft could circumvent the requirement that the remotely created checks not have a signature by simply forging the signature of the account holder. While this is true, at least the paying bank in that case still has the opportunity to examine and compare the signature, which it does have not today. Thus, even if fraudsters attempt to circumvent the rule by forging signatures, the proposal offers an important ability to help prevent the fraud associated with remotely created checks.

**Application to business checks.** The Board's proposed definition includes checks drawn on both consumer and business accounts. As noted earlier, ABA strongly agrees with this approach. Abuses associated with remotely created checks are not limited to consumer accounts. Indeed, business accounts are targets because they are more likely to have sufficient funds than consumer accounts. Moreover, there seems to be little justification to limit application of the proposal to consumer accounts as the 2002 revisions to the UCC do. The paying bank has the same inability to compare a signature, whether it is a business or consumer account.

**Clarification that definition covers state "remotely created check" terms.** We also ask the Board to help avoid challenges to existing state laws that may use different language to basically accomplish the same goal. We urge the Board to clarify in the final regulation that "demand drafts," "payee-initiated demand drafts," "remotely-created items," and "remotely-created consumer items" are included in the definition of "remotely created check." This clarification would foster harmony with state legislation in this area and avoid numerous preemption questions.

**Application to payable through drafts.** We suggest that the Board clarify in the regulation or Commentary that the proposed definition of remotely created check applies to unsigned payable through drafts. It is not clear that a check "drawn on a customer account at a bank" and bearing a signature of the "customer" includes payable through checks, because they do not generally bear the signature of the customer of the payable through bank. However, unsigned payable through drafts should enjoy the same warranties as unsigned checks because the institution deciding whether to pay the item lacks the opportunity to examine a signature.

***Alternate approaches.***

**UCC midnight deadline.** The Board also asks whether there are other approaches to addressing the risks associated with remotely created checks. For example, it asks whether it should extend the UCC midnight deadline, rather than create new warranties that are made outside the check collection and return system. We do not recommend extending the midnight deadline as doing so will create uncertainty about payment finality.

**Additional state law adoption.** We also urge the Board not to delay or refrain from acting and instead allow the states to adopt laws individually. If adoption by the states has been slow, as the Board suggests, it is not for lack of support for the concept. Rather, other, unrelated factors associated with the legislative and political process have stymied adoption. We believe that it is critical to move ahead quickly with

a federal regulation, given the importance of the proposal in addressing check fraud and the benefits of uniformity.

***MICR line identifier.*** The Board has also asked whether it may be useful to have a means of identifying checks so that banks can better protect themselves and their customers against fraud. For example, the ability to identify remotely created checks could be accomplished by assigning digits in the External Processing Code Field (Position 44) of the MICR line of remotely created checks.

As a practical matter, adding a MICR identifier to remotely created checks does little to assist *paying* banks in handling unauthorized unsigned remotely created checks. While an identifier might allow paying banks to sort such items, lacking a signature, there is little paying banks can do after such identification, outside of calling each customer, to determine whether the unsigned remotely created check is authorized. Some banks expressed interest in adding an identifier to remotely created checks so that the *depository* bank, which now bears the risk, could identify such items and develop a profile to detect and examine suspicious items. That the item is remotely created check would simply be one among other factors. However, overall, given the lack of usefulness for paying banks and the fact that there is a finite number of identifiers that should be reserved for check products and services that more merit such identification, we do not recommend that MICR line digits be used to identify remotely created checks.

***Conclusion.***

ABA appreciates and strongly supports the Board's initiative to address fraud matters associated with remotely created checks. We believe that the proposal will greatly assist banks in preventing and detecting such fraud. We strongly urge that it proceed with a final rule in this important matter.

Regards,

A handwritten signature in black ink that reads "Nessa E. Feddis". The signature is written in a cursive style with a large initial 'N' and 'F'.

Nessa Eileen Feddis