



Publisher of Consumer Reports

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Board of Governors  
Federal Reserve Board  
By electronic filing

Re: Docket No. R-1202, Collection of Checks and Other Items

Dear Board of Governors,

Consumers Union, the nonprofit publisher of *Consumer Reports*, the Consumer Federation of America, the National Consumer Law Center, and U.S. PIRG file these comments with respect to the proposed amendments to Regulation J to facilitate implementation of the Check Clearing for the 21<sup>st</sup> Century Act (Check 21). We ask the Federal Reserve Board to clarify that the purpose and scope of the proposed amendments is only to create definitions, rules, and warranties with respect to items that are being processed as checks. The Federal Reserve Board should explicitly clarify that the creation of a category of "electronic item" under Regulation J and the added cross reference in the definition of "check" under Regulation J have no effect on the status of electronic payments initiated with information taken from a check which now are treated as electronic fund transfers, not check transactions, and hence are now covered by the more favorable consumer protections of the federal Electronic Fund Transfer Act, including Regulation E.

The purpose of the added cross reference in the definition of "check" and the addition of a new category of "electronic item" appears to be to apply check warranties to check image information that is transferred between banks prior to or in lieu of the creation or transfer of a substitute check. However, a broader interpretation of the word "check" and the introduction of the concept of an "electronic item" in Regulation J would have unintended and harmful effects on consumers *if* these changes in Regulation J have any effect on the dividing line between checks and electronic fund transactions for other purposes, such as for purposes of Regulation E.

For this reason, we ask the Federal Reserve Board to augment the amendments to Regulation J to plainly state that these changes to check processing regulations have no effect on the fundamental question of whether a payment order initiated using information taken from a check is a check or instead is an electronic fund transfer governed by the Electronic Fund Transfer Act.

There already is confusion about the dividing line between electronically processed check images under Check 21 and voluntary truncation, on the one hand, and electronic check conversion under the EFTA and NACHA rules, on the other. This confusion will be exacerbated by the new options which Check 21 facilitates for financial institutions. For this reason, the national consumer groups filing this letter have suggested that the Check 21 regulations restrict the creation of check images to financial institutions, so that transactions where the merchant creates an electronic payment message from a check would always remain under the EFTA and Regulation E. Letter of Consumers Union and others dated March 5, 2004, Re: Docket # R-1176. However, if the final Check 21 regulations permit financial institutions to use their merchant customers as agents for the creation of check images, then the merchant's choice between check imaging and check conversion will effectively select the law – and the level of consumer protection – governing the payment.

The rules to implement Check 21 should not move the dividing line between checks and electronic fund transfers any further toward defining more types of electronically processed items as checks rather than as electronic fund transfers. Consumers have a real stake in whether an electronic payment initiated using information from a check is an electronic fund transfer or is a check payment, because consumers have better protections for electronic fund transfers than for checks. Regulation E provides a stronger set of practical and usable consumer protections than either the Uniform Commercial Code or the Check 21 Act. Regulation E is strongly preferable for consumers to the Uniform Commercial Code (if one has to choose only a single set of applicable law), because Regulation E provides the 10 day right of recredit. This gives consumers a practical, nonlitigation method to enforce their rights and a known timeframe in which disputed funds must be returned. By contrast, even though an unauthorized item is not properly payable under the UCC, the UCC provides no clear timeline for resolving disputes, so that the consumer may have to sue to effectuate a recredit to the account. The UCC also leaves open the possibility that the bank may assert that the consumer did not exercise “reasonable promptness” in statement review, or even (when a series of checks is involved) that the consumer was comparatively negligent. These complications simply do not arise under Regulation E.

Regulation E’s protections also are superior to the protections of Check 21. First, there is no dollar cap on the right to recredit under Regulation E. Second, it is at best unclear whether a consumer will have to be provided with a substitute check before the Check 21 recredit rights apply. There is no such additional step involved in claiming the right to recredit under Regulation E.

It does not appear that the proposed amendments to Regulation J were in fact intended to change the dividing line between checks and electronic fund transfers. But the amendments might be read that way. For example, the section by section analysis for section 210.5, on page 5 gives the example of “an electronic item created directly from an original check.” A reader might think that this refers to an electronic payment message created from check information which is converted into an ACH debit under the NACHA rules. A careful examination of the definitions of “check,” “item,” and “electronic item” proposed for Regulation J suggest that the amendments have no application to electronic check conversion, but are limited to electronic images of items that are being processed as checks. This limitation should be made plain.

For these reasons, we respectfully suggest that the Federal Reserve Board modify the proposed amendments to Regulation J to clarify that the definitions of “check” and “electronic item,” and the rules for processing electronic items, are for the purposes of Regulation J only. We suggest that the Federal Reserve Board add a statement to the commentary that the treatment of electronic items used in the processing of a check under Regulation J has no effect on POP, electronic check conversion, or other electronic fund transfers where information from a check is used to initiate an electronic fund transfer.

Very truly yours,

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