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July 26, 2004

Board of Governors of the  
Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, DC 20551

Attention: Ms. Jennifer J. Johnson  
Secretary

Re: Regulation J; Docket No. R-1202

Governors:

The Clearing House Association L.L.C. (“The Clearing House”)<sup>1</sup> is pleased to respond to your request for comments on the proposed rule that would amend subpart A of Regulation J to provide for the rights and obligations of sending banks, paying banks, returning banks, and Reserve Banks in connection with collection of substitute checks and items that have been converted to electronic form.

The Clearing House will be a signer on a group letter developed by several financial services industry organizations and technology companies and therefore supports the comments on Docket No. R-1202 contained in that letter. In addition, The Clearing House has three additional comments on Docket No. R-1202, which are set forth below.

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<sup>1</sup> The members of The Clearing House are: Bank of America, National Association; The Bank of New York; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank; LaSalle Bank National Association; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

1. The Warranties in § 210.6(b)(3) Should be Made to all Subsequent Collecting Banks.

Section 210.6(b) contains warranty and liability provisions that apply when a Reserve Bank presents or sends an item. We note that the parties to whom the warranties in § 210.6(b)(1) and § 210.6(b)(3) are made are inconsistent. The warranties in § 210.6(b)(1) are made to a broader scope of parties than the warranties in § 210.6(b)(3). The warranties in § 210.6(b)(1) (namely: Reserve Bank is entitled to enforce the item or is authorized to obtain payment on behalf of a person who is entitled to enforce the item or obtain payment or the item; item has not been altered; and item bears all indorsements previously applied) apply to all items. They are made “to a subsequent collecting bank and to the paying bank and any other payor.” The warranties in § 210.6(b)(3) (namely: item accurately represents all information on front and back of original check; item replicates MICR line of original check except for Regulation CC exceptions; item meets technical requirements in Fed operating circulars; and no party will be double debited for an item) apply to an electronic item that is not a representation of a substitute check. They are only made “to the bank to which it [Federal Reserve Bank] transfers or presents the item.”

We further note that the scopes of the Reserve Bank’s warranties in § 210.6(b)(3) and the sender’s warranties in § 210.5(a)(4) are also inconsistent. The warranties in § 210.5(a)(4) are the same warranties in § 210.6(b)(3). However, the warranties in § 210.5(b)(4) are made by a sender to “each Reserve Bank handling the item,” whereas the warranties in § 210.6(b)(3) are made by a Reserve Bank only “to the bank to which it transfers or presents the item.”

We believe the warranties in § 210.6(b)(3) should be made to the same parties as the warranties in § 210.6(b)(1): “to a subsequent collecting bank and to the paying bank and any other payor.” We believe that the first party that breaches these warranties in the collection chain should be ultimately liable for losses resulting from the breach. If the warranties are not made to a subsequent collecting bank, the subsequent collecting bank might unfairly suffer losses arising from an inaccurate electronic item created by a party prior to it in the collection chain.

Moreover, expanding the scope of the warranties in § 210.6(b)(3) would be consistent with the Board’s intention expressed in Section 210.6 of the Section-by-Section Analysis “to amend paragraph (b)[of § 210.6] along the same lines as § 210.5(a) so that the protections that the Reserve Banks give when they handle an item for forward collection parallel the protections that the Reserve Banks receive from senders.” The sender’s warranties in § 210.5 (a)(4) and the Reserve Bank’s warranties in § 210.6 (b)(3) are both related to an electronic item that is not a representation of a substitute check. However, the sender’s warranties are given to “each Reserve Bank handling the item” while the Reserve Bank’s warranties are only given to “the bank to which it transfers or presents the item,” not to each

subsequent collecting bank. In order to give a sender and a Reserve Bank parallel protection, the scopes of their warranties should be made the same.

Therefore, we recommend that the final rule expand the scope of the warranties in § 210.6(b)(3) to be consistent with § 210.6(b)(1) and § 210.5(a)(4).

Suggested Regulatory Text.

Section 210.6(b)(3)(3)(i). “If the item is an electronic item that is not a representation of a substitute check, the Reserve Bank (i) warrants to a subsequent collecting bank and to the paying bank and any other payor that ----- “

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In addition, the following change should be made to § 210.6(c) to make it conform to the suggested change to § 210.6(b)(3).

Suggested Regulatory Text.

Section 210.6(c) Limitations on Reserve Bank Liability. “A Reserve Bank shall not have or assume any liability to a subsequent collecting bank and to the paying bank and any other payor except as provided in paragraph (b) of this section or for the Reserve Bank’s own lack of good faith or failure to exercise ordinary care.”

2. The Indemnity in § 210.6(b)(3) Should be Expanded to Cover an Electronic Item That is not Later Reconverted Into a Substitute Check.

Under § 210.6(b)(3)(ii), a Reserve Bank only agrees to indemnify the banks to which it transfers or presents an item (that is not a representation of a substitute check) “for the amount of any losses that the bank incurs under § 229.53 of Regulation CC for an indemnity that the bank was required to make under § 229.53 in connection with a substitute check later created from the electronic item.” We have two problems with this indemnity:

1. it does not apply to all collecting banks and;
2. it appears not to apply if the electronic item is not later reconverted into a substitute check.

We believe that the indemnity should apply to all collecting banks and it should also apply to an electronic item that is never reconverted into a substitute check. We believe that each bank in the collection chain should indemnify subsequent collecting banks for the amount

of any losses arising from an inaccurate electronic item in order that the loss ultimately fall on the first bank in the collection chain that breaches the § 210.6(b)(3) warranties.

We suggest the following changes to expand the indemnity in § 210.6(b)(3)(ii) as discussed above:

Suggested Regulatory Text.

Section 210.6(b)(3)(ii). “Agrees to indemnify a subsequent collecting bank and the paying bank and any other payor:

- A. for the amount of any losses that it incurs under § 229.53 of this chapter for an indemnity that it was required to make under § 229.53 in connection with a substitute check later created from the electronic item; and
  - B. for the amount of any losses that it incurs as a result of Reserve Bank’s breach of a warranty under § 210.6(b)(3)(i).”
3. The Indemnities in § 210.5(a)(5)(iii),(iv) and (v) Should be Revised to be Consistent With § 210.6(b)(3)(ii).

As discussed above, we believe that each bank in the collection chain, private-sector banks and Reserve Banks alike, should warrant the accuracy of electronic items that they handle and indemnify all subsequent collecting banks against losses arising from their breach of warranty. However, we do not understand why in § 210.5(a)(5)(iv) and (v) a bank that sends an electronic item to a Reserve Bank should indemnify each Reserve Bank handling the item for any loss or expense sustained by the Reserve Bank for an indemnity made by the Reserve Bank under § 210.6(b). We do not believe that a Reserve Bank should be able to shift losses from its indemnity back to a sender if the sender did not breach a warranty under § 210.5(a)(3) or (4).

As also discussed above, we believe that each bank in the collection chain should make the same warranties and indemnities in connection with an electronic item.

The following suggested change to § 210.5(a)(5)(iii)(iv) and (v) would make the indemnities related to an electronic item given by a sender and by a Reserve Bank under our suggested change to Section 210.6(b)(3)(ii) substantially the same.

Suggested Regulatory Text.

Section 210.5(a)(5)(iii). [Revise § 210.5(a)(5)(iii) and (iv) and remove § 210.5(a)(5)(v).]

“ (iii) any warranty made by the Reserve Bank under § 210.6 (b)(1); and (iv) the sender’s breach of a warranty under § 210.5(a)(3) or (4) of this subpart.”

The point of contact regarding this letter at The Clearing House is Henry Wysocki. He can be reached at 212-612-9316.

Very truly yours,

A handwritten signature in cursive script, appearing to read "J. Beahm", with a horizontal line underneath the name.