SOUTHEAST CORPORATE

March 12, 2004

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

Re: **Docket No**. **R-1176 Comments to Regulation CC Amendments**

Dear Ms. Johnson:

Southeast Corporate Federal Credit Union appreciates the opportunity to comment on a proposed rule ("Proposal") set forth by the Board of Governors ("Board" or "Federal Reserve") to amend Regulation CC and its commentary ("Commentary") to implement the Check Clearing for the 21st Century Act (the "Check 21 Act" or "Act") and improve Regulation CC overall. Southeast Corporate Federal Credit Union ("Southeast Corporate"), the credit union's credit union, represents approximately 500 state and federal chartered credit unions. This letter reflects the views of Southeast Corporate's check processing management.

SUMMARY OF SOUTHEAST CORPORATE'S POSITION

Southeast Corporate strongly supports:

- Treating all substitute checks as the legal equivalent of the original check regardless of whether there is an error in the Magnetic Ink Character Recognition (MICR) line on the substitute check.

- Requiring a reconverting bank to print the MICR information from the original check on every substitute check that it creates. A failure by the reconverting bank to do so should be considered a breach of the Check 21 Act warranties.

- Ensuring that the reconverting bank, collecting bank and returning bank can repair a MICR line on a substitute check without incurring additional liability under the Check 21 Act, so that they are not discouraged from repairing MICR errors on substitute checks.

- Providing equivalent liability among the first and second reconverting bank, when the first reconverting bank does not provide notice that it is creating a substitute check.

- Payment requests are covered by warranties when a second charge results from an ACH debit that was created using information from an original or substitute check.

- Including the new definition of "transfer and consideration" in the Proposal, which allows a paying financial institution to transfer a substitute check to its members or customers.

- Referring to general industry standards in the regulation and mentioning specific standards in the Commentary. This placement gives the Federal Reserve the flexibility to change the standard or add a new standard within the Commentary, which can be more readily changed.

- Incorporating the usage of "banking day" in the Proposal, as opposed to "business day."

- Shortening the consumer awareness notice so that a consumer is more likely to read it.

- Including within the final rule sample notices, for the Check 21 Act notice requirements and specifying that the Federal Reserve deem usage of these notices as compliance.

- Eliminating the requirement to notify consumers when a claim is valid, such a notice is unnecessary as the consumer will receive a recredit.

- Allow financial institutions, which have not already provided disclosures, to provide a consumer awareness notice with the substitute check. This allows institutions to centralize requests and guarantee compliance.

- Maintaining the current time frames for notice of nonpayment.

- Clarifying the current rules regarding the extension of the midnight deadline.

- Adopting a new Regulation CC warranty regarding unsigned, remotely created items, after the Federal Reserve submits a specific warranty that can undergo the rulemaking process.

- Requiring disclosures in Regulation CC to be consistent with the requirements of the Electronic Signatures in Global and National Commerce Act (the E-Sign Act) and adopting language that clarifies the acceptability of e-mail.

- Clarifying the definition of "local bank."

- Additional commentary to 229.54 concerning expedited recredit procedures for consumers with specific examples along with revising recredit timeframes as they are cumbersome and are not easy for the consumer to understand specifically "on 10th business day if a bank has not yet determined validity of the claim, bank is required to provide the amount of the substitute check up to $2500 and then provide additional or remaining amount on the 45th business day". This is hard to manage for financial institutions and even harder for the consumer to understand. Our suggestion would be to provide the consumer provisional credit which can be reversed if the recredit claim is not valid.

BACKGROUND

The Check 21 Act was signed into law on October 28, 2003, and it will become effective on October 28, 2004. The law is designed to facilitate the electronic exchange of checks by making processing of electronic checks voluntary and not mandatory. The law does not mandate that all financial institutions be willing to accept electronic checks, but all institutions must accept a "substitute check" instead of the original share draft or check. The substitute check is the paper copy of the electronic check file.

The Check 21 Act establishes the law for the creation and exchange of substitute checks. This Act covers all share drafts and checks and makes all of them eligible for conversion, including: consumer and business checks, Treasury checks, official checks, teller's checks and traveler's checks. The proposed regulation on the Check 21 Act would be placed within Regulation CC (the Board's regulation on checks) in a new subpart D and would include the requirements of the Check 21 Act that affect financial institutions who create or receive substitute checks or paper or electronic representations of substitute checks. Subpart D contains the following provisions: the requirements a substitute check must meet to be the legal equivalent of an original check; the duties of the financial institution that converts a check into a substitute check (the reconverting bank); the warranties and indemnities associated with substitute checks; expedited recredit procedures for consumers and banks that suffer a loss due to substitute checks; liability for violations of subpart D; samples of the consumer awareness disclosure and other disclosures regarding substitute checks; and the endorsement and identification standards for substitute checks. The Board also proposes revisions to several other parts of Regulation CC and its Commentary. This letter addresses the changes in the Proposal that implement the Check 21 Act and other suggested changes to Regulation CC.

DISCUSSION

Legal equivalence for Substitute Checks with MICR Errors

Southeast Corporate strongly supports treating all substitute checks as the legal equivalent of the original check regardless of whether there is an error in the Magnetic Ink Character Recognition (MICR) line on the substitute check. Currently, the Proposal makes certain errors a reason to deny the legal equivalence of some substitute checks. For instance, the Proposal states that when there is a failure to correct the amount on the MICR field then that substitute check would remain valid as the legal equivalent of the original. However, when there are errors in the MICR line with regard to the routing and/or transit number, then those substitute checks would not be the legal equivalent of the paper check. By choosing to distinguish among MICR line errors and denying legal equivalence to some items, the Proposal introduces new liabilities into the check collection system and will create uncertainty regarding the handling of substitute checks. Southeast Corporate believes that even if the MICR line on the substitute check does not accurately represent the MICR line on the original check, the substitute check should still be the legal equivalent of the original check, regardless of whether the error is in the amount field or some other field.

By establishing a clear rule on MICR errors, the Federal Reserve would introduce certainty that all parties could routinely process substitute checks, like their electronic or paper counterparts, secure in the knowledge that they are indeed the legal equivalents of the original checks. Credit unions that collect or pay substitute checks and the consumers that receive them should know that they

could process substitute checks and treat them as the equivalent of the original check. If a substitute check were not the legal equivalent, then a paying credit union would have no authority to charge its member account, even if the paying credit union could determine that the substitute check was otherwise properly payable, regardless of the MICR encoding error. Likewise, a collecting credit union would have no authority to repay the substitute check or to present the check to the paying credit union to obtain payment. Similarly, consumers should be able to rely on the substitute check as the legal equivalent of the original check for proof of payment purposes. As a result, the denial of legal equivalence by the Proposal defeats the intent of the Check 21 Act; that is to introduce the substitute check as a reliable, negotiable instrument.

The final rule should require a reconverting bank to print the MICR information from the original check in MICR ink on every substitute check that it creates. The MICR line from the substitute check should contain all the information from that check. If the reconverting bank does not place the entire, correct MICR line on the substitute check, then it has breached the Check 21 Act warranty requirement that it "accurately represents all of the information on the front and back of the original check" as required under Section 5 and Section 4 of the Act.

Encourage MICR Repair on Substitute Checks

Southeast Corporate also supports revising the Proposal to ensure that the reconverting bank, collecting bank and returning bank can repair a MICR line on a substitute check without incurring additional liability under the Check 21 Act. Presently, reconverting banks are discouraged from repairing misencoded MICR lines on the substitute check. The final rule should clarify that a reconverting bank may repair a MICR line on a substitute check after it creates that substitute check. This repair of a substitute check would involve the addition of a strip to the bottom of the check and the printing of the correct MICR line information on that strip. This would permit a reconverting bank to correct any portion of the MICR line on a substitute check, if the bank realizes, after the creation of the check, that the incorrect MICR line will result in an error in the delivery or processing of the substitute check. Repair of a substitute check by a reconverting bank should not result in a separate breach of the Check 21 Act warranties and should not affect the status of the substitute check as the legal equivalent of the original checks.

> Southeast Corporate proposes the Commentary text below to implement the position above.
>
> *Proposed Text For Commentary*:
>
> Section 229.2(zz); Definition of Substitute Check: (##) A reconverting bank shall encode a substitute check in MICR ink with the MICR line information appearing on the original check, except as provided under generally applicable industry standards. If the MICR line on the substitute check does not accurately represent the MICR line on the original check, the reconverting bank has breached its warranty under Section 5 of the Act. A reconverting bank may repair the MICR line of a substitute check after the creation of the substitute check. An inaccurate MICR line on a substitute check as a result of repair or creation does not affect the status of the substitute check as the legal equivalent of the original check.

Ultimately, if the reconverting bank does not place a MICR line on a substitute check that matches the original check's MICR line, and another credit union or consumer experiences a loss, then the warranties and indemnities under the Check 21 Act as written should and would protect that person. The warranties and indemnities under the Check 21 Act from the reconverting bank will protect subsequent parties to the extent any liability arises from the receipt of a substitute check with MICR line information that does not "accurately represent" the MICR line information on the original check.

Southeast Corporate also believes that the Proposal should encourage collecting and paying financial institutions to treat and repair the MICR lines on substitute checks in the same manner that they would treat and repair original checks. As a result, the Proposal should provide that a collecting credit union or a paying credit union could voluntarily repair any portion of a MICR line on a substitute check that it receives in the check collection process. Although these repairs should be allowed, they should not be mandatory. When a collecting or paying financial institution does repair a substitute check, that repair should not invoke the Check 21 Act warranties, regardless of whether it is done correctly or whether the full or partial MICR line is placed on the repaired substitute check. Instead, the collecting or paying financial institution that repairs a substitute check in a manner that results in an inaccurate MICR line would breach the encoding warranties under the Uniform Commercial Code ("UCC") and Regulation CC.

Southeast Corporate believes that the above proposed treatment of repair by collecting financial institutions and paying financial institutions would encourage equivalent repair treatment of checks and substitute checks in the check collection process. If the Proposal, imposed the Check 21 Act warranties and new liabilities on those institutions that repaired substitute checks, these requirements would discourage financial institutions from repairing substitute checks and would hinder check processing. If all other parties were discouraged from repair, paying credit unions and other paying financial institutions could receive a disproportionate number of substitute checks with bad MICR lines.

Southeast Corporate proposes the Commentary text below to implement the position above.

Proposed Text For Commentary:

Section 229.2(zz); Definition of Substitute Check: (##) A bank, other than a reconverting bank, may repair the MICR line on a substitute check. A repair that alters the MICR line of a substitute check such that it does not accurately represent the MICR line of the original check does not result in a breach of a warranty under the Check 21 Act; although it may result in a breach of the encoding warranties prescribed in the Uniform Commercial Code (Article 4-209) and Section 229.34 of this Regulation (see e.g., the Section 229.34(c) encoding warranties). Repair of a substitute check does not affect the status of the substitute check as the legal equivalent of the original check.

Address Inconsistent Liability Among Reconverting Banks

Southeast Corporate requests that the Federal Reserve revise the Proposal, so that there is equivalent liability among the first and second reconverting bank, when the first reconverting bank does not provide notice that it is creating a substitute check. Southeast Corporate is aware that the failure of a reconverting bank or a collecting bank to correctly encode position 44 eventually could

result in an illegible substitute check further down the collection chain. In one scenario, a subsequent financial institution may create a second substitute check. Without the proper encoding in position 44, this second substitute check could contain a reduced inaccurate image of the original check because the second reconverting bank was not put on notice to preserve the size of the image of the original check. As a result, the first encoding error may leave the second reconverting bank with consequential damages to the consumer for a breach of a Check 21 Act warranty. Unfortunately, the second reconverting bank would not be able to recover these consequential damages from the first reconverting bank because the first institution merely violated the provisions of the Act and not the warranties. The Federal Reserve stated that it was not the purpose of the Check 21 Act to disadvantage those that received the substitute checks. The second reconverting bank should not be penalized for processing a substitute check properly, when the first reconverting bank is at fault. We urge the Federal Reserve to specify in its Commentary that the error of the first reconverting bank to properly encode position 44 of the MICR line makes it liable for breach of the Check 21 Act warranties under the Proposal.

Southeast Corporate proposes the Commentary text below to implement the position above.

Proposed Text For Commentary:

Section 229.2(zz); Definition of Substitute Check: (##) A bank that fails to properly encode position 44 on a substitute check, has breached its warranty under Section 5 of the Act.

Eliminate Concept of "Purported Substitute Check"

Southeast Corporate requests that the provisions in the Check 21 Act that create the concept of a "purported substitute check" be eliminated from the final proposal. Section 229.51(c) of the Proposal provides that if a substitute check meets all the requirements for a substitute check, except for the MICR line requirement, then that check is subject to the warranties and indemnities, but is not the legal equivalent. This section should be deleted. As was discussed earlier, all parties who receive a substitute check should be assured that it is the legal equivalent, and the warranties and indemnities of the Check 21 Act should protect them and all parties that receive these items. In place of this section, the final rule should include the rules discussed earlier regarding the legal equivalency of a substitute check, regardless of whether there is an incorrect or altered MICR line.

Definitions and Standards

Southeast Corporate supports the new definition of "transfer and consideration" that is incorporated within the proposal. Section 229.2(bbb) clarifies that a "transfer" includes the transfer of a substitute check from a paying financial institution to its customer, and that the Check 21 Act applies to the paying bank's creation and transfer of a substitute check to its customer. We support this new definition as set forth in the Proposal, as well as the example in the Commentary of a paying institution creating a substitute check for delivery to its member. Southeast Corporate believes that paying financial institutions should have this option to deliver substitute checks to their members or customers.

Southeast Corporate believes that the Federal Reserve should refer to general industry standards in the regulation and mention specific standards in the Commentary. The Federal Reserve requests

comments on its proposed treatment of generally applicable industry standards. The Federal Reserve proposes that it use the rule to refer to "generally applicable industry standards" and that it use the Commentary to specifically delineate the standard if there is a single one. The Federal Reserve opines that if it uses this approach, then it could adapt to changes in industry standard simply by amending the Commentary and that the Federal Reserve would not need to change the underlying regulatory requirement that refers to a general standard. Southeast Corporate believes that the financial sector should rely on a specific set of standards, so that substitute checks are uniform. The exclusive list of standards should be set in the Commentary, which can be more easily changed than the regulation. This placement gives the Federal Reserve the flexibility to change the standard or add a new standard within the Commentary.

Adopt "Banking Day"

Southeast Corporate supports the usage of "banking day" in the Proposal, as opposed to "business day." The Federal Reserve proposes to incorporate into the regulation the term "banking day" as it has for other parts of Regulation CC. Banking day means "that part of any business day on which an office of a bank is open to the public for carrying on substantially all of its banking functions." The Federal Reserve believes that "banking day" is an appropriate term when referring to the time limits for a bank to provide a recredit and make funds available for a recredit. The Board proposes to require recredit action by a financial institution no later than "the end of the 10th business day after the banking day" on which the consumer submitted a claim. Because the term "banking day" in Regulation CC has the same definition as "business day" in Regulation E, defining all of the Check 21 Act expedited recredit rules in terms of banking days would make them consistent with the recredit timing rules for electronic transfers in Regulation E. Southeast Corporate believes the consistent application of consumer recredit rules for all types of payments is fundamental to promoting consumer's understanding of their rights and financial institutions' responsibilities in connection with deposit accounts.

The Proposal Should Apply to the Check 21 Act Substitute Checks and the Check 21 Act Warranties

Southeast Corporate supports the exclusion of duplicative ACH debit payments from the Check 21 Act warranties. The Federal Reserve requests comments on whether a duplicate debit resulting from an ACH debit created using information from the original check or substitute check results in a violation of the Act's duplicate payment warranty. A second charge to an account resulting from an ACH debit entry initiated using an original or substitute check should not be subject to the warranties under § 229.52(a). The ACH rules already provide that an originating depository financial institution warrants that the ACH debit entry is authorized, and, under ACH rules, may be returned for recredit if a consumer claims it is unauthorized. Therefore, it is unnecessary to subject an originator of an ACH debit entry to a second set of warranties under the Check 21 Act. To eliminate potential confusion over this issue, we recommend the Federal Reserve clarify in its rules that an ACH debit entry initiated using information from a check is not an "electronic version" of a check under Regulation CC rules.

Southeast Corporate proposes the Commentary text below to implement the position above.

Suggested Commentary Text:

"Section 229.52(a)(2). A reconverting bank that has presented a substitute check to a paying bank would not be in breach of the warranty under Section 229.52(a)(2) and Section 5(2) of the Act in the event that an electronic fund transfer, such as an ACH debit, is subsequently initiated using information obtained from the original check or the substitute check relating to that original check. An electronic funds transfer does not result in a "payment based on a check" that would cause a breach of this warranty. The customer whose account was inappropriately debited for this electronic fund transfer would have the protection provided under electronic fund transfer law.

Similarly, the expedited recredit provisions of the Check 21 Act should not apply to UCC warranties, as it is specified under the Proposal. Under the Check 21 Act, for a consumer to make a claim the consumer must allege that the consumer has a "warranty claim with respect to such a check." It was generally assumed that the warranty claim the Act referred to was a warranty claim found within the Check 21 Act. The Commentary states in Section 229.54(a)(2), however, that a consumer has the right to an expedited recredit claim for a breach of UCC warranties with respect to a substitute check. The expedited recredit rights in the Check 21 Act should be limited to circumstances presented within the Act itself. The purpose of the Check 21 Act was to authorize the creation and use of substitute checks. The Check 21 Act was not intended to alter the manner in which current check law applies to a substitute check or the manner in which financial institutions resolve disputes with their consumers under current check law. Consumers are fully protected from breaches of UCC warranties under the UCC. As a result, Southeast Corporate asks that the Federal Reserve remove the section of the Commentary in 229.54(a)(2) that expands the Act to process UCC warranties.

Consumer Disclosures

Southeast Corporate supports a shorter consumer awareness notice that a consumer is more likely to read. The Check 21 Act requires that the Federal Reserve include a consumer awareness notice and it specifically refers to a "brief notice" within section 12 of the Act.[1] Southeast Corporate supports education of consumers through disclosures. The model disclosure currently drafted by the Federal Reserve, however, would probably not advance the consumer education goals of the Check 21 Act. The model notice is more than two pages long. Consumers are less likely to read such a lengthy and technical notice. Southeast Corporate asks that the Federal Reserve provide a shorter disclosure that references a website or an account agreement. A shorter notice is more likely to be read by consumer, and better fulfills the purposes of the Act.

Southeast Corporate recommends the disclosure text below:

Model Disclosure:

"You may receive from us in certain cases a substitute check, instead of the original check you wrote. For example, you may receive a substitute check, instead of an original check,

[1] Under the Act, the Federal Reserve can create a model notice that can serve as a safe harbor for financial institutions that use that notice as long as it accurately represents the institution's practices.

in your account statement, when you request a copy of a paid check, or when checks that you deposited are returned unpaid and charged back against your account. A substitute check is a copy of the original check that is the same as the original check for all purposes, including that you made payment. A substitute check is the size of a typical business check, includes an accurate copy of the front and back of the original check, and contains the words: "This is a legal copy of your check. You can use it the same way you would use the original check."

Federal law provides consumer customers with certain rights, including an expedited recredit of the amount of the check (up to $2,500 within 10 days and the remainder no later than 45 days), plus interest for interest bearing accounts, if you incur a loss because you received a substitute check instead of your original check. We may reverse a recredit after our investigation of your claim, if we determine that the substitute check was properly charged to your account. If you believe you incurred a loss because you received a substitute check, please contact us by [insert bank contact information]. You must contact us within 40 calendar days of the later of (i) your receipt of your monthly statement showing the substitute check being charged to your account, or (ii) the date we made the substitute check available to you. We may in certain cases extend this 40 day time period."

We have prepared the text above for consideration. However, even if the above text is not acceptable for the final rule, we still strongly urge the Federal Reserve to reduce the size and complexity of the model notice in the Final Rule.

Southeast Corporate supports the inclusion in the Proposal of sample notices for situations in the Check 21 Act that require notice and requests that the Federal Reserve explicitly state that it deems usage of these notices as compliance. Unlike the consumer awareness notice, the Act does not provide a "safe harbor" to financial institutions that use these other sample notices. Nonetheless, Southeast Corporate asks that the Federal Reserve specify in its final regulation, that the Federal Reserve considers the use of these notices by a financial institution to constitute compliance with the Check 21 Act. The Federal Reserve's support of its own notices would provide support for a finding of compliance by a court or alternative forums.

While Southeast Corporate generally supports the guidance on sample notices, we do not support the Federal Reserve's proposal to require financial institutions to notify consumers in writing when a claim is valid. If the claim is valid, then consumers will receive reimbursement, in light of the recredit. Moreover, although § 229.54(c)(1) of the Proposal requires that financial institutions provide notice to consumers when it is determined that their claims are valid, the Check 21 Act does not mandate this requirement. The requirement for notification should follow Regulation E, which allows oral and written communication within three days.

According to the Proposal, unless the bank already has provided the disclosure, a case-by-case disclosure is required when (1) a consumer receives a substitute check in response to his or her specific request for an original check or a copy of a check or (2) a check deposited by a consumer is returned unpaid to the consumer's account in the form of a substitute check. The Board has proposed two alternative rule provisions regarding when a bank must provide the disclosure to a consumer who requests a copy of a check. One alternative tracks the statute and requires a bank to

provide the disclosure at the time of the request, but the other alternative requires provision of the disclosures at the time the bank provides the substitute check to the consumer. The Board requests comment on which of the alternatives is preferable.

Southeast Corporate requests that the Federal Reserve allow financial institutions to provide a consumer awareness notice with the substitute check; however, we encourage the Federal Reserve to offer both options to financial institutions. The Proposal must allow financial institutions to provide a notice, when the substitute check is received and not requested because the financial institution does not know at the time the consumer requests the check whether or not a substitute check was used.

Southeast Corporate proposes the below Rule text to implement the above position.

Suggested Regulatory Text:

"Section 229.57(b)(2) . . . (i) Requests an original check or a copy of a check and receives a substitute check by or at the time the bank provides such substitute check."

In the Proposal, the Federal Reserve clarifies that a bank may reverse the interest paid in the recredit, as well as the recredit if the claim is found to be invalid. The Commentary also clarifies that a bank may, when appropriate, reverse any amount that it previously recredited, regardless of whether such amount originally was provided after a determination that a claim was valid or pending the bank's investigation. The Board requests comment on whether additional commentary would be useful and, if so, what specific points should be covered. Southeast Corporate supports the Federal Reserve's clarification that a financial institution may reverse the interest paid in a recredit transaction. An account holder should not be unjustly enriched from interest paid on a denied claim.

Southeast Corporate supports inclusion of more examples that explain the relationship of the Check 21 Act to other law. The Commentary at various points attempts to clarify the interaction between the rights and remedies conferred by the Check 21 Act and those conferred by other law, particularly the UCC. The Board specifically requests comment on whether the proposed commentary is adequate with respect to the interaction between the Check 21 Act and existing law or whether additional discussion and examples are needed. If the latter, the Board requests specifics in describing which provision of the Check 21 Act needs clarification and to identify examples that should be added to the commentary.

The Federal Reserve could add the following clarification to the rule:

Definition of "Reconverting Bank," Section 229.22(yy)
Section 229.2 (yy) of the proposal defines "Reconverting Bank" to be:

(1) The bank that creates a substitute check; or
(2) The first bank to receive the substitute check and transfers, presents, or returns the substitute check or, in lieu of a substitute check, the first paper or electronic representation of the substitute check that was created by a nonbank.

In item "3" of the proposed commentary to this section, the Board notes:

> A bank also is a reconverting bank if it is the first bank that receives a substitute check created by a nonbank and transfers, presents, or returns that substitute check or, in lieu thereof, the first paper or electronic representation of such substitute check. Under § 229.51, a substitute check is the legal equivalent of the original check only if a bank has made the substitute check warranties listed in § 229.52. **A bank therefore is not required to accept a substitute check that was created by a person other than a bank and has not yet been transferred by a bank, although a bank may agree to do so** *(emphasis added).*

Southeast Corporate seeks clarification from the Board on two issues regarding this section. First, can a bank become a reconverting bank without the bank's knowledge and assent? And second, can the "substitute check" created by a nonbank and transferred to a bank actually be a "substitute check" if the bank has not granted permission to the nonbank to utilize the bank's routing and transit number?

Southeast Corporate's questions are evidenced in the following example:

Company A, which is not a bank, by agreement receives incoming paper checks for processing in the forward chain on behalf of Bank A. Bank A did not image the items nor forward an electronic file to Company A, but instead presented normal paper items. Company A believes it is in their company's best interest to convert these paper checks into substitute checks. Company A then provides the substitute checks to Bank B for payment.

Under the proposal, Company A, as a nonbank, is clearly not eligible to be the reconverting bank. In this example who would hold that status: Bank A who deposited the paper items with Company A or Bank B who is first to receive the substitute checks created by Company A?

Unrelated Regulation CC Amendments

Southeast Corporate supports the adoption of a new Regulation CC warranty regarding unsigned, remotely created items, after the Federal Reserve drafts a specific warranty and submits it to the rulemaking process. The Federal Reserve is seeking comment on whether Regulation CC should be revised to incorporate new warranties relating to unsigned remotely created demand drafts. These new warranties would be similar to the warranties recently adopted by the National Conference of Commissioner on Uniform State Law for UCC Articles 3 and 4. The UCC revision defines a remotely created consumer item to mean "an item drawn on a consumer account, which is not created by the payor bank and does not bear a handwritten signature purporting to be the signature of the drawer." The UCC revision would allow a paying bank to use a warranty claim to absolve itself of responsibility for honoring this type of item if a drawer claims it is unauthorized. This revision rests on the premise that monitoring by depository banks can control this type of fraud more effectively than any practices readily available to paying banks. This new warranty should apply to consumer checks as well as commercial checks as it is broader than the warranty included in the revised UCC. Other improvements on the UCC warranties could be found during a request for comments, so Southeast Corporate supports including a similar provision in Regulation CC, after the public has a chance to review the warranties within the context of a proper comment period. Southeast Corporate generally would support the inclusion of a new warranty in Regulation CC, because that allows for national adoption and it is much quicker than relying on ratification of the UCC in each state.

Southeast Corporate does not support reduction of the timeframes for notice of nonpayment. For checks in the amount of $2,500 or more, both corporate and retail credit unions indicate that the time frames should remain as they are.

Southeast Corporate generally supports requiring the disclosures in Regulation CC to be consistent with the requirements of the Electronic Signatures in the Global and National Commerce Act (the E-Sign Act) and support adopting language that clarifies the acceptability of e-mail. The Board proposes to amend the commentary to §229.13(g) regarding notices of exception holds to clarify that a bank providing such a notice electronically to a consumer must comply with the E-Sign Act. Similarly, the Board proposes to amend the commentary to § 229.15(a) regarding the general form of notices required by subpart B to clarify that a bank providing a notice electronically to a consumer must comply with the requirements of the E-Sign Act. The Federal Reserve also proposes amending the text of § 229.33(b) – the requirement that the paying bank quickly send notice of nonpayment of an item of $2,500 or more to the bank of first deposit. The Federal Reserve proposes to state that a financial institution must "send or give" the consumer notice regarding receipt of a returned check or notice or nonpayment. Southeast Corporate asks that the Federal Reserve use the word "provide" instead of "give." This change is more inclusive of e-mail notification, which may or may not be opened by a consumer. This terminology would also clarify that the notice need not be in writing.

In addition, Southeast Corporate supports the Federal Reserve's proposal to allow more flexible usage of notices. The Board proposes adding a sentence to the commentary to § 229.10 (c) to clarify that a special deposit slip notice need not be posted at each teller window, although it must be posted in a place where consumers are likely to see it before making a deposit.

Southeast Corporate supports the Federal Reserve's proposal to more clearly define "local bank." Regulation CC distinguishes between local and nonlocal items in terms of the deadlines for funds availability. To clarify how an item is considered, the Federal Reserve proposes to amend the commentary for the definition of "local paying bank" (12 CFR § 229.2[s]) to provide additional detail on how to determine when deposits mailed to a central check processing facility are local or nonlocal.

Southeast Corporate supports the Federal Reserve's proposal to clarify the current rule regarding extension of the midnight deadline. The UCC requires the payor bank that wishes to dishonor a check to dispatch it either to the depository bank or to a returning bank for forwarding to the depositary bank by midnight on the next banking day after the banking day on which the payor bank had received the check. Failure to make the deadline requires the payor bank to pay the check. The current rule allows extension of up to one day when a paying financial institution uses a means of delivery that ordinarily would result in receipt of the check by the receiving bank's next "banking day."

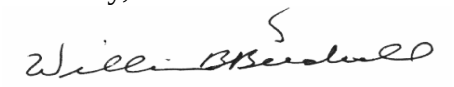
In a recent court case, the court interpreted the current provision to permit an extension of the midnight deadline even when the check was received by a returning bank at a time that was too late for the bank to process the check that day. In effect, the court found that a Federal Reserve Bank, the returning bank in this case, has no end to its "banking day" and thus allowed a return up until

midnight of the day following the midnight deadline. The proposed amendment to Regulation CC would effectively overrule this decision and make it clear that the check must be received by the returning bank's cut-off hour for the next check processing cycle (if sent to a returning bank). Southeast Corporate supports this change because most credit unions adhere to the midnight deadline and clarifying the deadline for the extension further protects credit unions.

Conclusion

Southeast Corporate commends the Federal Reserve for providing an extended public comment period on this proposal to amend Regulation CC. If you have any further questions, please contact Southeast Corporate's Senior Vice President ,Correspondent Services, Kay Moon, (904) 861-2571.

Sincerely,



William Birdwell
President, CEO

WBB/lc