LINCOLN L. RUTTER
[redacted]

November 9, 2011

Ms. Jennifer J. Johnson
Board of Governors of the Federal Reserve System
Washington D.C.

RE: Docket No. R-1409 Regulation CC Revisions

Dear Ms. Johnson:

I appreciate this opportunity to comment in the matter of the contemplated changes to Regulation CC that the Federal Reserve System is currently evaluating. I have been laboring for quite some time to make bank regulators aware of a structural accounting problem that stems from the lack of a proper legal definition of what constitutes "presentment" under both Regulation CC and the Uniform Commercial Code (UCC). Now that electronic banking technology has rendered the old legal constructs obsolete a new definition is imperative. The purpose of this cover letter is simply to identify the attached documents which collectively represent my public comment so that the Board can quickly focus on the various aspects of this serious regulatory challenge.

The purpose of this public comment and the enclosed six exhibits are to formally make the Board of Governors of the Federal Reserve System aware of a bank accounting practice -- with its origin in the inadequate language of Regulation CC and the Uniform Commercial Code (UCC) -- that has been adopted by a group of approximately 12-14 banks, which is having a significant impact on the level of existing *payments system risk* and therefore represents an issue definitely involving the safety and soundness of the US banking system, an issue for which the Federal Reserve Board is singularly responsible. Additionally, the accounting practice in question also represents an *unfair and deceptive business practice* which has not been properly disclosed under the Truth in Lending statutes to the consumers of bank deposit services, therefore, the Federal Reserve Board also should make a policy decision regarding this very unique accounting practice on grounds that the practice has material and substantial *consumer protection ramifications* for which the Federal Reserve Board also has a clear mandate.

The accounting practice at issue involves the concept of "Electronic Premature Debiting" (EPD) whereby only these 12-14 banks agree to assign a "float factor" to a particular customer's check in the process of collection, through their respective "availability schedules," while separately agreeing between themselves to process and electronically transmit the same item from the Bank of First Deposit (BOFD) to the Paying Bank immediately for the purpose of prematurely debiting the funds from the account of the Drawer on a "same-day" basis. The dollar amounts of these electronically transmitted items will subsequently be "shared" by virtue of these same "business practices agreements" through the mechanism of *partial payment and partial settlement*, or "non-par banking," on the basis of half of the "presented" dollar amount being paid for in today's funds, with the other half being "deferred" (by agreement between these EPD practicing banks) until tomorrow's "banking business day." The result from an accounting treatment standpoint is that half of the dollar value of these checks will reside in General Ledger Suspense Accounts at the Paying Bank, overnight (or for an additional banking day), which creates massive unnecessary payments system risk, that would not have been created if the two financial institutions involved had paid for (or settled for) these items "at par" (or for 100 cents on the dollar) on a same-day settlement basis, as is the common accounting practice at the Fed and other private banks.

I estimate that greater than $100 billion dollars **each day** is "prematurely posted" to Demand Deposit Activity (DDA) accounts in this manner, via EPD, at just the top-10 U.S. banks alone. This level of EPD is therefore generating over $2 billion dollars annually in "Not Sufficient Funds" (NSF) charges, as well as depriving corporate account holders (those on deposit "analysis systems") of over $6 billion dollars in "earnings credits" annually that have in both cases resulted solely or directly from this accounting gimmick, as these NSF penalties and "negative float" amounts would not have occurred if it were not for this unique EPD accounting practice.

My qualifications for making this allegation is because I once owned an equity interest in The Chexs Partnership, between my company, AirNet Systems, Inc., The Huntington Bank, and Automated Financial Systems (AFS), which essentially founded The National Clearing House Association (NCHA) by providing settlement software and services to over 80 of the largest U.S. commercial banks. The NCHA as a "clearinghouse" processed and settled for between $80 and $100 billion dollars on a net settlement basis daily, during 1997. Previously, I managed float for a $23 billion dollar bank holding company. I know for a fact that this accounting treatment is occurring and I have petitioned the Federal Reserve Bank Freedom of Information Office (FOIA) for the documentary accounting evidence that would have allowed me to prove the existence of these tremendously high levels of General Ledger Suspense Account balances to the Board's satisfaction, although to date, without the cooperation of the Fed's FOIA Office.

Disclosure of this information **is in the public interest** because it is likely to contribute significantly to the public's understanding of the operations and the accounting practices of the Federal Reserve Banks vis-a-vis this "cartel" of private banks, and because the Federal Reserve Bank Operating Circular "Regulation CC" considers a check legally "paid" upon receipt of the electronic file alone, whereas, these approximately 12-14 banks have successfully (until now) avoided this Reg. CC mandate, by means of a loophole in the Uniform Commercial Code (UCC) called, "the Variation by Agreement Clause." This accounting manipulation not only victimizes consumers of bank deposit services, but it fundamentally and systematically intertwines the balance sheets of these institutions by the deliberate "suspension" of GL transactions that according to Fed's Reg. CC, should have been cleared and settled using conventional "due-to/due from" DDA accounting procedures, with payment "at par" and on a "same-day funds" basis. This accounting gimmick constitutes a massive (multi-billion dollar) abuse of the consumer, and a serious violation of the principles of safety and soundness, that underlay the public's confidence in our banking system, therefore, this is a subject that cries out for an immediate Federal Reserve Board policy decision, and the contemplated Reg. CC Revisions is the logical place and time to do it.

Sincerely,

Lincoln Rutter

[redacted]

December 17, 2010

Chairman Ben Bernanke
Board of Governors
The Federal Reserve System
20th & Constitution Ave. NW
Washington, D.C. 20551

Dear Chairman Bernanke:

The purpose of this letter and the enclosed exhibits is to make the Board aware of an abuse of our nation's payments mechanism that is being perpetrated by a subgroup of members of a "clearing house" organization of banks that have conspired together to manipulate the premature electronic posting of paper and electronic checks to create an unfair "negative float" income stream for themselves, and to significantly increase Not Sufficient Funds (NSF) charges experienced by those unfortunate Americans that currently have no surplus bank balances to protect themselves from this anti-competitive predatory pricing scheme. It is my hope that the Board of Governors will investigate the unique accounting practice thoroughly explained in these documents.

How do they say it: those that do not read history are condemned to repeat it? Apparently, few among us read the history of the Fed. The reason that the Federal Reserve Act of 1913 put what became 48 Fed Branch banks into operation clearing checks free for banks -- but at the taxpayer's expense -- was because the largest money center banks in cities like Chicago and New York had formed syndicates to *restrict or delay access* to deposits belonging to those bank's customers. The unreasonable and unilateral imposition of an explicit fee by such an anti-competitive association's members (15% or more of the face value of every check cleared for example) in exchange for the right to access those "correspondent bank's" check transportation and clearing network, was tremendously profitable for a select few conspiring banks. The practice was called "non-par" banking (i.e., banking for less than 100 cents on the dollar). At the turn of the century it was considered an appallingly inappropriate drag on the nation's economy by Congress and the Fed's operational presence was to become the "market-based" solution for what was commonly perceived in its day as a monopolistic *predatory pricing* scheme.

Today, because of a loophole in the *Uniform Commercial Code* (UCC) called the "Variation by Agreement Clause" (Section 1-302 enclosed for your review) a similar group of banks has taken advantage of new electronic data transmission capabilities to create the modern electronic equivalent of non-par banking. The variation by agreement clause originally dates from the 19th century and the need to accommodate the various time zones and local customs when designating a place and time for banks to meet each business day to exchange their bags full of checks at their local "clearinghouse." The UCC sought to allow for a convenient "variance" to be voluntarily agreed upon by each "association" of local banks. Unfortunately for our present consumers and our economy, a group of banks with very large nationwide franchises have apparently decided to "vary" under the UCC the time of the posting of the individual Demand Deposit Activity (DDA) debits so as to be separate from their corresponding inter-bank settlement credits, and *to delay the credit* to their customer's payee accounts by one whole banking business day. An implicit delay in the access to "on-demand" account balances, and its corresponding time value of money, is conceptually equivalent to an explicit non-par banking charge of a percentage of the face value of the check, with the exception that our modern non-par banking victim often does not even understand that a significant fee is being unilaterally charged by their bank, because the disclosure is totally inadequate. This is a clear violation of the Truth in Lending statutes, in my opinion, for which the Fed has jurisdiction.

The way the scheme works is this: each original paper check "presented" by a bank customer for clearance is duplicated by certain practicing/cartel member banks into two electronic documents; one is the electronic digitized "image" of the front and back of the item (the "electronic image" or "EI"), while the second, called the "**Notice of Presentment**" contains usually only the DDA account number and dollar amount "information" obtained from the original Magnetic Ink Character Recognition (MICR) line across the bottom of all checks. Each individual state's UCC laws allow for bank parties "by agreement" to set their own "standards" so long as the standards are not "manifestly unreasonable." However, at least one association of banks (rules of which are attached for the Board's review) appears to have set up their own "funds transfer system rule" in such a manner that credit to their customers is deliberately delayed until "payment by the beneficiary's bank of the payment order is accepted" which by virtue of their now being two legal instruments involved in that "payment order," not just one, means that there is a potential delay *to the posting sequence* clearly under the two exchanging (i.e., presenting and paying) bank's exclusive "bilateral agreement" control. Unfortunately for nearly all US corporations as well as the 47% of Americans that now live "from paycheck to paycheck" without any surplus "available" bank balances, some banks are taking unfair advantage of the ambiguous legal situation existing between the UCC and Regulation CC, regarding what constitutes "presentment," by transferring huge balances rightfully belonging to their account holders into a "general ledger suspense account" on the bank's books, through which these banks earn and share one-day's interest income *on each and every check* that was debited as a "notice of presentment," as opposed to an original "actual paid item." Please consider this letter as another formal *Freedom of Information Act* (FOIA) request by me, this time to get the Board to authorize a FOIA Request itself, to learn from the Fed Staff (I recommend either Louise Roseman or Terry Roth) what the average daily aggregate reciprocal "suspense account" balance level is at each of the top-10 US commercial banks specifically for these ECCHO "exchange" cashletters, for these ten banks whom the Fed regulates and for which the Fed has clear "consumer protection" responsibilities under the Federal Reserve Act.

Due to the nature of our presently highly concentrated bank deposit market power (i.e., the top-4 banks represent over 70% of US deposits), it is estimated that approximately **$100 billion** of "soft dollar" balances rightfully belonging to the customers of banks is drained away **daily** into these bank-owned General Ledger "suspense" accounts. Each million soft dollars is worth approximately $166.00 "hard dollars" at a 6% interest rate if corporate DDA account "earnings credits" are postulated as a substitute for alternative prime rate borrowings. Thus, the collective drag from this electronic non-par banking accounting practice on our national economy is measured at over $6 billion of hard dollars annually. However, most corporate treasurers have no idea that this "non-par banking" tax on their earnings credit is even occurring because of improper disclosure of these relative few bank's deposit processing fees. More importantly, electronically accelerating the debiting of Demand Deposit Activity accounts (DDA) by one whole banking business day increases the incidence of Not Sufficient Funds (NSF) fees by 4-7% and these fees range from $28 to $35 each. This is because more checks are artificially accelerated in this manner to clear on the 13th day while "the poor" wait in vein for their paycheck to arrive on the 14th day of their employment payday lifecycle. How such amounts do not violate usury laws beggars one's imagination. Yet, in addition to this unethical acceleration of posting on an inter-day basis, some banks also post transactions in descending dollar value order as opposed to "actual paid item" date to maximize their NSF fee income (please see *Gutierrez vs. Wells Fargo Bank*). The aggregate income to banks from bounced check fees are now estimated at $38.5 billion dollars annually by the Fed. Returned item fees are almost entirely profit to banks because it costs only approximately $0.02 to $0.04 to process a check through a computerized check sorter one additional pass on the next "cycle date," and less than 2% of NSF checks actually get returned. Furthermore, bankers know from their own electronic deposit experience that worker's paychecks <u>always</u> show up on the 14th day! Accelerating the posting of electronic "notices" as opposed to "actual paid items" (the subject of this Board policy decision request) therefore causes only the poorest among us, those without any surplus DDA balances, to bear the brunt of over $2 billion of hard dollar fees *that would not otherwise have occurred* without this deliberatly "deceptive and unfair" manipulation of our nation's payments mechanism, by an estimated 12 to 14 US banks.

When the Board of the Fed investigates the legality of this "non-par banking" scheme by fulfilling my FOIA request, they should please consider that the Federal Reserve System under its Operating Circular "Regulation CC" authority considers a check legally "paid" upon the receipt of *the electronic file alone*, whereas in contrast, the rules of this one electronic check clearing house organization, the Electronic Check Clearing House Organization (ECCHO), intentionally default to the old paper UCC-based interpretation *in the absence of appropriate laws* to govern the relatively recent advent of electronic banking technology. There is no definition of what constitutes electronic "presentment" in the UCC or regulation CC, therefore, the variation by agreement clause allows individual ECCHO members to bilaterally agree to wait until both their "notice" and the "actual item" have been received and processed, the timing of which is clearly under their individual member's own control, and therefore, potentially subject to manipulation, as I herein allege. The aggregate balances in the General Ledger accounts, i.e., the subject of my previous FOIA request, will prove to the Board's satisfaction not only the existence of this corrupt posting practice but will also demonstrate the enormity of its negative impact on consumers of bank deposit services.

I have enclosed for Board review copies of the relevant *Rules of The Electronic Check Clearing House Organization* (ECCHO), a large bank's "disclosure terms" which detail the practice of electronically accelerated debiting of demand accounts, and the specific *Uniform Commercial Code* section that constitutes the proverbial legal "loophole" which is presently allowing this non-par banking practice to grow very rapidly, as well as other relevant documents. Thank you in advance for your help in formulating an appropriate legislative or regulatory solution to this serious problem for consumers of bank services. Please note that our anti-trust laws shield such bank deceptive and unfair practices from our judicial system by virtue of the "doctrine of implied immunity" which assumes that the Federal Reserve Board has <u>**the legal responsibility**</u> to prevent such predatory pricing practices by the banks that the Fed regulates. If I can be of help to the Fed in your consumer protection mandate in this regard please let me know.

Sincerely,

Lincoln Rutter

TABLE OF CONTENTS

ECCHO RULES AND THE BALANCE "REPLENISHMENT BENEFIT" CONCEPT FOR REVIEW BY BANK REGULATORS

*This is the explanation of **HOW** banks are using electronic presentment to achieve an "unjust enrichment" at their customer's expense, as discussed in my introductory letter of November 1, 2010, addressed to Governor Hoenig.*

*I read in the Columbus (Ohio) Dispatch some time ago that the sum-total of all $28-35 "Not Sufficient Funds" (NSF) charges is now $53 billion dollars annually. However, the Seattle TV Channel-5 news stated that the total is $17B, while the CNBC financial news channel recently stated that the sum is $38.5 billion annually. I believe that the difference may represent the inclusion of the "debit card" penalties for "over-drafts," as distinguished from NSF fees, in addition to just check volume. In either case, increasing that amount by from 4 to 7% (as posting debits one-day prior to their corresponding credit does) represents $2.12B to $3.71B, or $680M to $1.19B dollars annually, respectively. In other words, we are talking about very large potential corporate damages if this **electronic** "premature debiting" practice is considered "unreasonable" under the UCC interpretation, regardless of which source's reported estimate of fees is correct. Since debiting potentially discriminates both against poor people that have* zero *in excess Demand Deposit Account (DDA) balances in their retail bank account, as well as corporate commercial checking accounts, regardless of their ledger balance level, it would seem (with a non-legal background) that the practice should one day be ruled as "manifestly unreasonable." It would also appear there are potentially very large "classes" of plaintiffs involved in any potential legal action.*

*In addition to these tremendous consumer revenues identified above, however, one must additionally focus on those debits electronically prematurely posted to corporate accounts that are on bank "analysis systems" which potentially cause the practicing bank's commercial customers to "replenish" their balances under artificially accelerated conditions. The electronically increased "deposit turnover" velocity rate reduces "customer balances" by transferring the amount of those "premature" debits into a bank-owned interest-bearing "suspense account" on the bank's General Ledger, overnight or for one "cycle-day" or "banking day" to the bank's exclusive monetary benefit, by systematically reducing "earnings credits" paid out. Please note that these represent deposit balances that will have been paid for in "immediately available funds" by those bank's corporate customers, and that these balances will become shared by the Bank of First Deposit and the Paying Bank through the unique mechanism of their "bilateral agreements." The corresponding settlement credit to the Payee's account at the BOFD only gets posted on the "next-day's business" cycle date, when the **paper** or MICR (Magnetic Ink Character Recognition) "notice of presentment" and the "actual item" both have been posted by the two mutually agreeing banks, which is what all of the language in the ECCHO Rules about "time periods" and "cut-off times" is all about. I estimate that corporate damages are three times greater than consumer's damages from the electronic transmission and premature posting practice in question.*

Please view the web site: www.ECCHO.org for the full ECCHO "Rules Summary." What follow are a few excerpts from those rules with my comments in capitals:

"The ECCHO Rules are clearinghouse rules under the UCC."

IN SECTION 4A-501 (b) ON MY **UCC VARIATION BY AGREEMENT CLAUSE** DOCUMENT SENT INDEPENDENTLY IT STATES: The "Funds-transfer System Rule (in this case ECCHO Rules)... are effective even if the rule conflicts with this Article and indirectly affects another party to the funds transfer who does not consent to the rule." MOST IMPORTANTLY, IN UCC SECTION 1-302 IT STATES: "Whenever (the UCC) requires an action be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed **by agreement**." THE POINT ALL OF THIS ANALYSIS IS THAT THE OBVIOUSLY SIGNIFICANT LOSS OF CORPORATE "EARNINGS CREDITS" AND THE PUNATIVE NOT SUFFICIENT FUNDS (NSF) CHARGES THAT ARE BEING APPLIED IN A DISCRIMINATORY MANNER (ONLY AGAINST THE POOREST AMONG US), IS "MANIFESTLY UNREASONABLE" ON ITS FACE.

"...the ECCHO Rules may vary provisions of the UCC with respect to a person interested in a check processed under the clearinghouse rules." (See Section II (B) of the Rules)

THE IMPORTANT "VARIATION" HERE IS THE ESTABLISHMENT OF A DUAL OR ONE ELECTRONIC (I.E., ECCHO RULES) AND ONE PAPER (I.E., UCC) SET OF RULES, AND THE DECISION TO USE UCC PAPER RATHER THAN ECCHO ELECTRONIC RULES, AS FAR AS THE CUSTOMER'S FATE IS CONCERNED, AS COMPARED TO THE FED'S REGULATION CC RULES WHICH WOULD HAVE PREVENTED THIS OBVIOUS ABUSE OF THE CONSUMER. THIS UNIQUE TO ECCHO POLICY DECISION CONSTITUTES A "DOUBLE STANDARD" COMPARED TO FED'S RULES AND/OR A DECPTIVE, UNFAIR BUSINESS PRACTICE.

"The ECCHO Rules do not expressly address the treatment of check images transactions or other electronic check transactions between a Member and its customers (both drawer customers and depositing customers). Rather, the relationship of a Member and its customer is governed by applicable law and the deposit agreement or other check processing agreement in place between a customer and a Member."

BY "APPLICABLE LAW" ABOVE ECCHO RULES MEAN UCC OR THE OLD PAPER CHECK LAW WILL GOVERN THE CUSTOMER'S LEGAL RIGHTS, BECAUSE ONLY THE ELECTRONIC DEBITING PRACTICE BETWEEN MEMBERS IS GOVERNED BY ECCHO RULES; OR ACCORDING TO ECCHO MEMBERS ARE THEMSELVES GOVERNED ONLY THROUGH "BYLATERAL AGREEMENTS" OR "BANKING PRACTICES AGREEMENTS" (BPA's) BETWEEN THOSE BANKS CHOSING TO USE THE PREMATURE ELECTRONIC DEBITING PRACTICE, OR NOT TO USE IT.

"In an exchange under the ECCHO Rules (ER), both the Electronic Image and the related MICR line information are sent or made available to the receiving Member. The MICR line information for a particular Electronic Image (EI) is referred to in the ECCHO Rules as the "presentation notice," and is transmitted either with the EI or within a certain time period of the sending of the EI."

NOTE THAT THEY REFER TO BOTH "ELECTRONIC IMAGES" AND "THE RELATED PRESENTMENT NOTICES." THE FACT THAT THERE ARE TWO FORMS OR DOCUMENTS IS WHAT DISTINGUISHES THE ECCHO RULES FROM THE FED'S

REGULATION CC "RULES" WHICH ONLY REQUIRE THE ELECTRONIC FILE TO LEGALLY CONSTITUTE "PRESENTMENT." THIS DISTINCTION IS THE CRUX OF WHY THE ECCHO RULES SHOULD BE CONSIDERED AS "UNREASONABLE" UNDER THE UCC, IN MY NON-LEGAL OPINION, BY THE FED.

"The receiving Member uses the information from the EI (and the related presentment notice) to make the payment or return decision *and to post the check to the account of the drawer customers*."

NOTE THAT THERE IS NO REFERENCE TO POSTING THE CREDIT TO THE PAYEE NORMALLY DESIGNATED AS THE "PAY TO THE ORDER OF" PARTY ON THE ORIGINAL CHECK, THAT WILL TAKE PLACE ONLY AFTER THE TWO ECCHO EXCHANGING MEMBERS HAVE FIRST AGREED TO "SETTLE" WITH EACH OTHER, ON THE "NEXT BANKING DAY" THROUGH THE MECHANISM OF THEIR ECCHO BILATERAL AGREEMENT DOCUMENTS.

"The ER define when presentment of the EI occurs. The EI is presented to the paying bank when both (i) the presentment notice associated with the EI and (ii) the EI are received by, or made available to, the paying bank. The ER establishes requirements for the presentment notice and/or the EI to be presented before certain cut-off times, or else be *deemed presented on the next banking day*." (See Section XIX (H) of the Rules.)

THE PURPOSE OF THE TRANSMITTED ELECTRONIC FILE IN MANY CASES IS SIMPLY TO MAKE THE DEBITS AVAILABLE FOR POSTING TO THE "DRAWER CUSTOMER'S ACCOUNT" AS THERE IS NO PROVISION FOR THE POSTING OF THE CORRESPONDING CREDIT UNDER THE ER. THIS IS THE SOURCE OF THE "NEGATIVE FLOAT" (OR "CREDIT FLOAT" TO THE BANK'S BENEFIT THROUGH A GENERAL LEDGER "SUSPENSE ACCOUNT" VEHICLE) THAT COLLECTIVELY REPRESENTS POTENTIALLY NEARLY ONE HUNDRED BILLION GROSS "SOFT" US DOLLARS DAILY! ECCHO LITERATURE REFERS TO THIS "SUSPENDED" AMOUNT AS THE "BALANCE REPLENISHMENT BENEFIT" WHICH IS BEING SHARED THROUGH THESE BILATERAL AGREEMENTS.

"There are a number of time periods and other processing requirements that must be satisfied in order for the sending Member to be obligated on the warranty claim to the receiving Member. The warranty is unique under the ER in that the warranty is only made by the depositary bank to the paying bank, and not by or to intervening collecting banks."

ECCHO RULES ARE CERTAINLY UNIQUE FROM ALL OTHER "CLEARINGHOUSES" IN THE US IN REGARD TO THIS DUAL SYSTEM OF ECCHO RULES AND REGULATIONS (VS. UCC LAW) AND THIS FACT CONSTITUTES A CLEAR DOUBLE STANDARD CURRENTLY ACTIVE UNDER THE UCC. SOME BANKS CLAIM THAT FED'S REGULATION CC DOES NOT APPLY TO THE PRIVATE SECTOR.

"The warranty claims processes do not address the relationship between a Member and its customer."

THE FACT THAT THIS SCHEME IS "UNFAIR AND DECEPTIVE" SPEAKS FOR ITSELF. I LOOK FORWARD TO ALSO LEARNING THE FEDERAL RESERVE SYSTEM'S CONCLUSION ABOUT WHETHER THE EXCESSIVE "SUSPENDED" BALANCE LEVELS -- (DELIBERATELY DELAYED IN TERMS OF CREDIT POSTING AND FINALITY OF SETTLEMENT) WHICH ARE INSTEAD CURRENTLY BEING HELD IN GENERAL LEDGER SUSPENSE ACCOUNTS FOR AN EXTRA BUSINESS DAY -- CONSTITUTE AN UNSOUND BANKING PRACTICE IN THE EVENT OF AN FORESEEN BANRUPTCY OF A BANK PARTY TO THIS PREDATORY PREMATURE POSTING SCHEME.

IMPORTANT LEGAL INFORMATION, DISCLOSURES, AND TERMS BANK REGULATORS NEED TO KNOW

(A SAMPLE LARGE BANK "CONSUMER ACCOUNT AGREEMENT")

What follows are some excerpts from a large commercial bank's account agreement, with my comments in italics:

"The rights in this notice do not apply to original checks or to electronic debits to your Account."

Please note that there is no reference to electronic credits, this is because the "funds transfer system rule" maintains a dual system whereby electronic credits flow between presenting and paying banks at different time intervals and on different "banking business days" than the corresponding electronic debit transmissions.

"Unless otherwise agreed in writing, the Bank may, without inquiry, accept a deposit to your Account at any time, from any party, made in any manner, including without limitation, a deposit based on an image of an Item."

This term sets the stage for the flow of electronic debits to be received from the Electronic Check Clearing House Organization (ECCHO) members (the legal custodians of the "Funds Transfer System Rule") and posted to drawer customer's accounts by virtue of the newly separated Notice of Presentment "notification" document (which is entirely different from the original check and its image). Please notice that this term also allows for sophisticated corporate treasurers to "otherwise agree in writing" not to participate "without inquiry."

"The bank may place a hold on your Account if the bank receives an electronic notice that an Item will be presented for payment or collection against your account (a "Notice of Presentment")."

ECCHO rules state: "In an exchange under the ECCHO Rules, both the Electronic Image and the related Magnetic Ink Character Recognition (MICR) line information are sent or made available to the receiving Member. The MICR line information for a particular Electronic Image (EI) is referred to in the ECCHO Rules as the "Presentation Notice," and is transmitted either with the EI or within a certain time period of the sending of the EI." This duality is the crux of the scheme to manipulate the timing of the processing of the two separate documents which replaced the single original check.

"The Bank may conclusively rely on the information it receives in an electronic presentment or notification when determining the available balance in your Account."

Please note that the "information" relied upon (i.e., the Notice of Presentment) is not the same thing as a properly cleared check although the affect of that reliance by the banks acting under ECCHO bilateral agreement does indeed lower the available balance in the drawer's account.

"The Bank may debit your Account on the day an Item is presented by any means, including without limitation, electronically, or at an earlier time based on notification received by the Bank that an Item drawn on your Account will be presented for payment or collection."

Please note that the Notice of Presentment (only one of the two ECCHO replacements for the original check) is given the status of a "presentment" for the purpose of debiting a drawer's account at the Payee Bank but not equal status for crediting the payee's account at the Bank of First Deposit (BOFD).

"The bank may post Items presented against the Account in any order the Bank chooses, unless the laws governing your Account either requires or prohibits a particular order. For example, the Bank may, if it chooses, post Items in the order of the highest dollar amount to the lowest dollar amount."

Note that posting in descending dollar value order as opposed to by the date of presentment, like accelerated electronic debiting, multiplies the number of Not Sufficient Funds (NSF) charges by orders of magnitude to the financial detriment of retailers incurring increased "charge-offs" and by the economic degradation of the lower financial bracket consumer's disposable income. (Please see Gutierrez vs. Wells Fargo Bank.) The present FOIA Request postulates that deposit sequencing of "transit check" posting, as in the recent Court case sited above, is also occurring on an inter-day basis by certain conspiring banks, acting in concert.

"Do not assume that you can make a covering deposit before the Item is presented for payment because Items are often presented for payment very quickly."

The instantaneous nature of electronic transmissions is only problematic for consumers of banking services because the financial benefit associated with the credit dollar amount has been subverted by the banks involved in these bilateral agreements. In other words, if both the credit and the debt were posted at the same time as is the case with the Federal Reserve System's Regulation CC posting practices (not deliberately delayed through a "loophole" in the Uniform Commercial Code called the Variation by Agreement Clause) then the incidence of NSF charges would be substantially reduced, as would the rate of disbursement account "balance replenishment" by corporate account drawers.

"If there is an Overdraft in your checking Account, the Bank will automatically access available funds in the accounts(s) you have linked to your checking Account to cover the Overdraft so the available balance in your checking Account is sufficient to cover paid Items and/or Notices of Presentment."

The instantaneous nature of electronic transmission also means there is potentially more dollar value debiting associated with Notices of Presentment occurring under ECCHO Rules than there are actual paid items. This is because banks selectively "dollar cut" and handle larger value items differently and more quickly than smaller dollar denominated items. It would be in the public interest of the nation's bank regulators to learn what this incredibly expensive ratio (of "actual paid items" to "notices") really is and there is a safety and soundness aspect to this process of suspending payments on bank's books that would otherwise have settled in immediately available funds.

"If you deposit non-cash Item, such as a check, interest begins to accrue no later than the Business Day that the Bank receives credit for the deposit of that Item."

Complying with this statement is the sole purpose of the second of the two electronic documents that replaced the original check. Why would banks go to the expense of duplicating check *information twice if there were no "credit float" or "negative float" economic benefit or incentive involved? It is the customers of banks that are bearing the tremendous cost of maintaining this duality within the nation's payments mechanism and the Fed is clearly responsible for the negative impact this delaying of settlement credit causes consumers of bank services.*

"Each funds Business Day, the Bank calculates the difference between the deposits to and withdrawals from your Transaction Account. The difference is referred to as the "Net Sweep Amount."

Note that when a corporate treasurer funds the "zero balance account" each day the "Net Sweep Amount" includes tremendous amounts of dollars that represent these Notices of Presentment for which the corporation's intended "payee" will not receive credit until the following business day. Banks have General Ledger "suspense accounts" into and out of which such funds are booked that correlate to earned interest income to the bank's benefit by increasing the bank's net interest margin, at the expense of customer's otherwise "earnings credit."

"Funds transfers to or from your Account will be governed by the rules of any funds transfer system through which the transfers are made, as amended from time to time, including, without limitation, Fedwire, the National Automated Clearing House Association, any regional associations (each an "ACH"), and the Clearing House Interbank Payments System (CHIPS). The following terms and conditions are in addition to, and not in place of, any other agreements you have with the Bank regarding electronic transactions."

It should be revealing to bank regulators to notice that only some electronic clearing houses, like ECCHO, do not consider a check paid upon the receipt of the electronic files (as does Fed's Reg. CC), those listed above do consider a check paid upon the receipt of the electronic file; while one of the largest US electronic clearing houses, ECCHO was not listed in this large bank's Consumer Account Agreement. ECCHO's is obviously a unique interpretation of when a check is legally considered "paid." Such unique interpretations should be investigated by the Fed with regard to Fed's consumer protection mandate.

"Unless the Bank has otherwise agreed in writing, we will notify you of funds electronically debited or credited to your Account through the statement for your Account covering the period in which the transaction occurred. The Bank is under no obligation to provide you with any additional notice or receipt."

It should certainly be interesting for a bank regulator to read one of these "bilateral agreements" that some ECCHO members appear to use to coordinate the scheduling of the electronic debiting of drawer's accounts, yet while preserving for them the balance "replenishment benefit" associated with the credit posting, would it not? The purpose of this FOIA Request is to identify, using Fed bank examiner's documents, the current average daily balance levels being held in GL suspense accounts at the Top-10 US banks to determine the affect on consumers from this electronic premature debiting practice and to determine if proper "disclosure" under the law has occurred.

UNIFORM COMMERCIAL CODE (UCC)
"VARIATION BY AGREEMENT CLAUSE"
THE SOURCE OF DDA BALANCE "REPLENISHMENT BENEFITS"

What follows is the UCC language as it relates to the practice of "premature debiting" of DDA Accounts, for review by Bank Regulators. My observations are in capital letters after each section.

§ 1-302. Variation by Agreement.

(b) The obligations of good faith, diligence, reasonableness, and care prescribed **by** [the Uniform Commercial Code] may not be disclaimed **by agreement**. The parties, **by agreement**, may determine the standards **by** which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever [the Uniform Commercial Code] requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed **by agreement**.

DELIBERATELY INCREASING THE INCIDENCE NSF CHARGES BY AN ACCOUNTING TRANSACTION TIMING DELAY SHOULD BE "MANIFESTLY UNREASONABLE" UNDER THE UCC'S DEFINITION OF "REQUIRING AN ACTION TO BE TAKEN." GIVEN THAT IT COSTS A BANK ABOUT $0.02 TO PROCESS A CHECK THROUGH AN IBM-3890 COMPUTERIZED CHECK SORTER A SECOND TIME ON THE NEXT DAY'S "CYCLE" DATE, $28-35 WOULD SEEM "UNREASONABLE." ELECTRONIC TRANSMISSION OF AN "ON-US" ITEM WHEN FOLLOWED BY "IMMEDIATE" DDA POSTING WHILE THE SAME ITEM RECEIVED A ONE WHOLE "BANKING BUSINESS DAY" DELAYED "FLOAT DEFERMENT" WOULD SIMILARLY SEEM "UNREASONABLE" TIMING UNDER SECTION 1-302'S "ACTION TO BE TAKEN" LANGUAGE.

§ 4A-107. FEDERAL RESERVE REGULATIONS AND OPERATING CIRCULARS.

Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency.

THE FACT THAT THERE IS A DOUBLE STANDARD CURRENTLY BEING DEPLOYED, IN THE SENSE THAT FEDERAL RESERVE BANK "OPERATING CIRCULARS" PURSUANT TO FED'S REGULATION CC AUTHORITY SPECIFICALLY STATE THAT A CHECK IS CONSIDERED "PAID" UPON RECEIPT OF ONLY THE ELECTRONIC DATA FILE, WHILE THE ELECTRONIC CHECK CLEARING HOUSE ORGANIZATION (ECCHO) RULES, FOR EXAMPLE, MAINTAIN THAT A CHECK IS NOT CONSIDERED "PAID" UNTIL THE FINAL RECEIPT OF BOTH THE "NOTICE OF PRESENTMENT" AND THE ELECTRONIC IMAGE OF THE "ACTUAL ITEM" TRIGGER THE BANKS INVOLVED TO PAY EACH OTHER – ON A DAY DELAYED BASIS -- WOULD ALSO SEEM "UNREASONABLE" UNDER SECTION 1-302. IF THE SOLE PURPOSE OF THE CHECK'S DUPLICATION IS UNJUST ENRICHMENT OF A

RELATIVE FEW BANKS, THEN THE “VARIATION” IN THE FUNDS TRANSFER RULE SHOULD BE CONSIDERED BY REGULATORS AS UNREASONABLE UNDER THE UCC.

§ 4A-405. PAYMENT BY BENEFICIARY'S BANK TO BENEFICIARY.

(d) A funds-transfer system rule may provide that payments made to beneficiaries of funds transfers made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted.

IT IS REASONABLE FOR CONSUMERS TO EXPECT THAT BOTH THE CREDIT AND THE DEBIT WOULD BE "EXECUTED" ON THE SAME BANKING DAY. THIS IS THE ESSENCE OF THE REASONABLE GROUNDS FOR OBJECTION BY CONSUMERS TO THE COLLECTIVE BANK ACCOUNTING GIMMICK OF POSTING ONE “BANKING BUSINESS DAY” DEFERED-SETTLEMENT CREDIT ITEMS (ON THE BANK OF FIRST DEPOSIT’S BOOKS) YET POSTING ON AN IMMEDIATE “SAME-DAY” DEBITING BASIS (ON THE PAYING BANK’S BOOKS) WHILE THE TWO BANKS HAVE PREVIOUSLY AGREED TO SHARE THE ECONOMIC VALUE OF THESE UNECESSARILY SUSPENDED ACCOUNDING TRANSACTIONS.

§ 4A-507. CHOICE OF LAW.

(c) A funds-transfer system rule may select the law of a particular jurisdiction to govern (i) rights and obligations between participating banks with respect to payment orders transmitted or processed through the system.

THE LEGAL BURDEN OF PROOF SHOULD FALL UPON THOSE BANKS PREMATURELY DEBITING THEIR CUSTOMER’S ACCOUNTS TO EXPLAIN WHY THEIR CLEARINGHOUSE RULE MANDATES THAT CHECKS ARE NOT CONSIDERED LEGALLY “PAID” UNTIL THE RECIEPT OF THE ORIGINAL PAPER (OR “MICR” TRANSMISSION) IN ADDITION TO THE IMAGE OF THE “ACTUAL ITEM,” (UNIQUELY KNOWN IN ECCHO PARLANCE AS “PAYMENT ORDERS”) BECAUSE THAT “CLEARINGHOUSE RULE” IS ALLOWED TO CAUSE AN ACCOUNTING DELAY THAT CREATES VAST AMOUNTS OF FINANCIAL HARM TO CONSUMERS OF BANK SERVICES, WHILE THE FED'S REGULATION CC "RULES" REQUIRE PAYMENT TO BE CONSIDERED COMPLETE BY BANKS, UPON RECEIPT OF THE ELECTRONIC DATA FILES ONLY, IMMEDIATELY TRANSACTED IN FULLWITHOUT SUCH AN ARTIFICIAL DELAY, AND WITHOUT ANY APPARENT FINANCIAL DAMAGE TO CONSUMERS.

§ 4A-501. VARIATION BY AGREEMENT AND EFFECT OF FUNDS-TRANSFER SYSTEM RULE.

(b) "**Funds-transfer system rule**" means a rule of an association of banks (i) governing transmission of payment orders by means of a funds-transfer system of the association or rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a Federal Reserve Bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this Article, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective **even if the rule conflicts with this Article and indirectly affects another party to the funds transfer who does not consent to the rule.** A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in Sections 4A-404(c), 4A-405(d), and 4A-507(c).

TODAY'S DUAL PAYMENTS SYSTEM, ONE ELECTRONIC (ECCHO) AND ONE PAPER (UCC), WHERE A QUESTION AS FUNDAMENTAL AS: WHEN IS A CHECK CONSIDERED LEGALLY "PRESENTED" OR "PAID?" IS ANSWERED TWO DISTINCTLY DIFFERENT WAYS, IS "MANIFESTLY UNREASONABLE" AND THOSE THAT CREATED SUCH AN "UNFAIR AND DECEPTIVE" DUAL BANKING SYSTEM ARE POTENTIALLY IN VIOLATION OF "THE OBLIGATION OF GOOD FAITH, DILIGENCE, REASONABLENESS, AND CARE PRESCIBED BY THE UCC" AND THIS RESPONSIBILITY "MAY NOT BE DISCLAIMED BY AGREEMENT" AS IS STATED IN **ARTICLE 4, SECTION 1-302 OF THE UCC**.

IMPLICATIONS AND AFFECTS OF PREMATURE DEBITING OF DDA ACCOUNTS FOR BANK REGULATORS TO INVESTIGATE

The following are some issues raised by the practice by some banks of electronically debiting their customer's deposit accounts using "notices of presentment" one banking business day before "settlement" of the "actual paid item" has been structured to occur:

- All "Top-20" largest US banks have multi-billion dollar balance levels in a general ledger (GL) "suspense account" that correlates to the amount of their premature debiting of their customer's accounts; a simple audit by the Fed would prove this.
- There is a significant increase to the "net interest margin" at banks where what was "float" (a "non-earning asset") in their customer's account has suddenly been transformed into an "earning asset" generating income for the bank's exclusive benefit, at their customer's expense. "Negative float" is not the same thing as "no float."
- Not only are bank CEO's aware of the intense profitability of the posting practice, but the Comptroller of the Currency, FDIC and OCC Bank Examiners must have noticed the billion dollar GL account balances on these bank's financial statements.
- The $38.5 billion dollars in aggregate Not Sufficient Funds (NSF) fee income represents tens of millions of dollars in *annual income* to certain banks, even smaller than the "Top 50," and such income from corporate "balance replenishment" also often gets booked on the financial statements and reported as "Cash Management Income."
- While the practice originated during the 1980's as Electronic Check Presentment or "ECP," and tape recorded seminars at the Bank Administration Institute (BAI) will evidence this fact, an unintended consequence of *The Check Clearing for the 21st Century* Act ("Check 21") is responsible for its recent rapid growth among the Top-10.
- As co-operating competitor banks, the 20 "full members" of the Electronic Check Clearing House Organization (ECCHO) also jointly own companies engaged in payments system activities such as ViewPointe Image Archive and The Small Value Payments Company (SVPCo), and bankers have coined the unique phrase, "co-opetition" to refer to the newfound co-operative (as opposed to competitive) spirit in collectively designing new products and services, to their collective customer's detriment.
- Approximately 85% of paper check volume is capable of being cleared completely electronically while 15% of the 32 billion checks written annually are still cleared in "substitute document" paper form; while the cost of clearing paper checks *before* Check 21 was on average $0.02 - $0.04 cents per check, the paper check cost now is $0.096 cents per item.
- Banks practicing premature debiting are generating such huge profits from it that they have elected to "dollar-cut" and separate checks over $2,000.00, for example, from smaller denominated transactions, so that the "negative float" income stream from the practice can be maximized while the low-dollar items must wait for processing, becoming "hold-over float" as their collection time gets lengthened by one business day, compared to the paper check clearing experience before the Check 21 legislation.
- From the perspective of bank customers, the nation's payments mechanism has become less efficient, in the sense that consumer's are experiencing higher check processing fees, increased NSF charges, and increased need for DDA "balance replenishment," while most of the economic benefits associated with the speed of electronic transmission have been withheld by the largest banks, since Check 21 was adopted.

This situation clearly violates the Unfair and Deceptive Acts and Practices provisions of Section 18(f) of the Federal Trade Commission (73 Fed. Reg. 28904 May 19, 2008); the simple solution is to have the Fed *adopt a regulation* that a check is legally considered "paid" upon the receipt of the electronic files (which the Fed already deems per the EFA Act to constitute "presentment") and the Uniform Commercial Code (UCC) "Variation by Agreement Clause" made subservient to that new regulation.

ISSUES TO RAISE AT THE FEDERAL RESERVE SYSTEM REGARDING ELECTRONIC PREMATURE DEBITING OF CONSUMER'S DEMAND DEPOSIT ACCOUNTS (DDA)

The following issues should be raised by *both* legislators and bank regulators in regards to the "non-par" banking practice of electronic premature debiting of DDA accounts through which certain banks are taking "unfair and deceptive" advantage of US consumers:

- The *Depository Institutions Deregulation and Monetary Control Act* (of 1980) made the Fed more concerned with "revenues" than its consumer protection mandate, because if the Fed failed to generate a cost/revenue match, then Fed would have had to withdraw from certain check processing markets. This aspect of the Act should be reversed by Congress.
- The *Federal Trade Commission (FTC) Act* (of 1914) declared all unfair methods of competition to be illegal. The FTC is responsible for enforcing the Sherman *Anti-Trust Act* (of 1890), the *Clayton Act* (of 1914), and the FTC Act. The *Wheeler Lea Amendment* (of 1938) makes the FTC responsible for eliminating all deceptive business practices, whether or not they restrict free trade. Under this Amendment, a seller cannot engage in any practice that is intended to fool or deceive the consumer. The *Wheeler – Lea Act* also covers truth in advertising. To the extent that consumers have no idea that premature debiting is even occurring, and that it constitutes a hidden "fee," banks engaged in the practice are violating the FTC mandate relating to truth in advertising.
- The *Clayton Act* outlawed price discrimination or the practice of giving a larger business a lower price than other consumers, whereas, premature debiting mostly victimizes the poorest of consumers. The *Clayton Act* forbids interlocking directorates from competing businesses, whereas, I believe Electronic Check Clearing House Organization (ECCHO), Viewpointe Image Archive, and The Small Value Payments Company (SVPCo) all have interlocking directorates and common equity ownership, and these corporations also have a community of interest in terms of stock ownership which could provide motivation to reduce competition.
- The *Sherman Anti-Trust Act* defines certain business practices as illegal, for example, when two or more businesses agree to charge a specific price for goods or services. When the ECCHO "bi-lateral agreements" between participating members divide the proceeds derived from premature debiting of DDA accounts (i.e., the "replenishment benefit") between themselves (on a basis such as an 80/20, 60/40 or 50/50 percentage split), there is knowledge aforethought that the posting practice will constitute an implicit "fee" of one banking day's funds availability or "float" and the time value of money that it represents. Therefore, the Department of Justice has the power to enforce this provision of the Act.
- The *Robinson-Patman Act* (of 1936) outlawed price differentials that substantially weaken competition unless the seller can justify them showing that the actual selling costs associated with servicing larger size customers are lower. In the case of premature debiting affecting <u>only</u> poor consumer's Not Sufficient Funds (NSF) charges, there is <u>no</u> underlying cost to the bank whatsoever of providing this accelerated posting service to *either* large or small depositors. The point being that advertized check clearing "fees" make no mention (or disclosure) of the premature debiting cost to the consumer, therefore, there can be no "cost" to a service that has no "price;" therefore, no justifiable argument can be made on behalf of these sellers. On the other hand, Community banks that do not have national franchises could easily prove that they have been blocked from effectively entering the depository services market, in competition with the large money center banks that operate

nationwide branch banking networks, because the intense profitability from "implicit" premature electronic debiting subsidizes the "explicit" fees associated with check processing – anti-competitive "free checking" -- in favor of the "Top 20" largest banks which enjoy these anti-competitive interlocking ownership positions.

- Many of the Top 20 "full members" of ECCHO that also jointly own and operate SVPCo and ViewPointe in the nation's payments mechanism space successfully acquired and merged together several independent financial institutions to the point where now just the "Top 4" banks control over 70% of the US bank deposit market. Whereas, the *Celler – Kefauver Act* (of 1950) outlawed mergers through the purchase of assets if those mergers reduced competition. Obviously, community banks without national branch banking networks and DDA systems that can post in a dual or discriminatory manner are fundamentally disadvantaged by the anti-competitive nature of the ECCHO by-lateral agreements existing between the largest US financial institutions. The *Antitrust Improvement Act* (of 1976) has strengthened the Justice Department's investigative authority which should become activated with respect to this non-par banking allegation.
- The Electronic Check Clearing House Organization (ECCHO) is <u>not</u> a "clearinghouse association" under the Uniform Commercial Code's (UCC) definition because ECCHO does not provide settlement services. ECCHO only makes rules and advocates for "bilateral agreements" and bilateral settlement which is the logical antithesis of the clearinghouse concept which implies net settlement as a more safe and sound means of settlement than bilateral or gross settlement. The Fed should accordingly find the ECCHO "funds transfer system rule" in violation of the UCC's reasonableness test, because the Fed is the Regulator of ECCHO members individually, regardless of whether the Fed regulates "clearinghouses" per se.

The above laws regulating competition have made our Federal Government the "watchdog" to ensure that businesses behave in accordance with society's principles of fairness and reasonableness. In my opinion, this posting situation clearly violates the Unfair and Deceptive Acts and Practices provisions of the *FTC Act*. Therefore, I believe that Representative Maloney's bill (H.R. 1456) to give consumers control over their overdraft loans <u>must</u> be expanded by the Fed to address the practice of premature debiting of DDA accounts which acts to increase the incidence of NSF charges by 4-7% on average, in order for that control to be meaningful. The Federal Reserve System has a responsibility to mobilize its full oversight resources to assist legislative authority in a manner that addresses the electronic premature debiting practice's massive negative economic implications for US consumers.

NON-PAR BANKING REVISITED: ELECTRONIC PREMATURE DEBITING

The essence of "non-par banking" was the willingness of certain banks at the turn of the century to restrict the open and free access by consumers to the funds that those banks held on deposit. The fee or discount – a percentage of the face value of the check – was responsible for the term "non-par" banking, but the act of *restricted access* was what made consumers of deposit services willing to pay that fee. The present case of electronic premature debiting of depositary accounts earns an income stream for the practicing banks only because they are able to restrict access to their "on-demand" DDA balances in the form of a "float factor" or "credit deferment" imposed by the Bank of First Deposit's (BOFD) published Availability Schedule on those same items for which the Paying Bank has a clear fiduciary responsibility to its account holder to access "on-demand." The crux of the practice is the "bilateral agreement" between two competitor banks to simultaneously "float" one customer's check transaction (one banking business day) while at the same time agreeing between themselves, as two competing banks, "to post" or "to debit" the same item today at the Paying Bank and to share the economic gain to be had from these synchronized accounting transactions. The anti-competitive predatory pricing aspect has its roots in those "bi-lateral agreements" which "fix" the pricing conduct of both the BOFD and the Paying Bank's collective accounting responsibilities designed to take mutual advantage (through their exclusive cartel) of the consumers of banking services, by an agreement to share the time-value of the money that gets electronically prematurely debited via the price fixing scheme. Banks without bilateral agreements to share the "balance replenishment" benefit are at a competitive disadvantage relative to those with such revenue sharing agreements. "Free Checking" is obviously not free in the presence of shared premature debiting revenue and banks without sharing agreements cannot possibly compete with such a potential cartel.

ON FED'S WEBSITE UNDER: "BANKING INFORMATION AND REGULATIONS"

PART 229--AVAILABILITY OF FUNDS AND COLLECTION OF CHECKS (REGULATION CC)

§ 229.20 Relation to state law.

(a) *In general.* Any provision of a law or regulation of any state in effect on or before September 1, 1989, that requires funds deposited in an account at a bank chartered by the state to be made available for withdrawal in a shorter time than the time provided in subpart B, and, in connection therewith, subpart A, shall—

(1) Supersede the provisions of the EFA Act and subpart B, and, in connection therewith, subpart A, to the extent the provisions relate to the time by which funds deposited or received for deposit in an account are available for withdrawal; and

(2) Apply to all federally insured banks located within the state.

No amendment to a state law or regulation governing the availability of funds that becomes effective after September 1, 1989, shall supersede the EFA Act and subpart B, and, in connection therewith, subpart A, but unamended provisions of state law shall remain in effect.

REGULATION E: ELECTRONIC FUNDS TRANSFERS (EFT)

ELECTRONIC CODE OF FEDERAL REGULATIONS (e-CFR) TITLE 12 - SECTION 205-3: EFT DEFINED

18(b) Alternative to Periodic Statements

1. *Posted transactions.* A history *of transactions provided under §§205.18(b)(1)(ii) and (iii)* **shall reflect transfers once they have been posted to the account**.

> The crux of the premature debiting agreement is this: when a hypothetical corporation funds its disbursement account at 0800 on Tuesday morning (EST), for example, to "zero" the balance, the amount it will pay includes items that were physically presented at the Bank of First Deposits (BOFDs) after their 2:00 PM (local time) ledger credit deadline on Monday afternoon. These items will have come to the disbursement bank electronically from all over America via many "Top 50" banks. The original paper check items will have incurred a float "deprovement" factor to that corporation's intended Payee of one "banking business day" because they were drawn on a "regional" (or Regional Check Processing Center "RCPC") transit and routing number in a distant Federal Reserve District. Therefore, the BOFD will have booked that deposit on Tuesday's ledger but with a float assignment representing Wednesday's *settlement*, while the BOFD subsequently electronically transmitted that item directly to the Paying Bank (the corporation's disbursement bank) **for posting** to that receiving bank's general ledger "suspense account" (and out of the corporation's DDA or "demand deposit" account) on Monday night, so that the payment information could then become included in the total that the corporation paid for on Tuesday morning, as though the check represented "good" or "collected" funds, which in actuality it does not; the "notice of presentment" must be combined with the "actual item" in order to represent an ECCHO "payment order." However, please note that one day's "credit float" or "negative float" will have been generated between the BOFD and the Paying Bank (members of the "syndicate" or "cartel") in this scenario, in the sense that the intended payee experienced "float" on a check that our hypothetical corporation paid on a same-day basis (i.e., Tuesday). Most importantly, on the first day that this electronic transmission and bank **suspense account-posting** (premature; provisional; in lieu of actual settlement posting) practice started our corporation would have noticed that two day's average deposit turn-over would have occurred on that first Tuesday morning, however, every morning thereafter the amount that the corporation funds would appear to average a similar average amount. The inappropriate posting acceleration that I seek to thoroughly document for bank regulators takes place between the BOFD and the Paying Bank on the front-end of nearly every corporation's check payment transactions, not after they have funded their account, which is perhaps why so few corporate CEO's, CFO's or Treasurers have ever observed this phenomenon in action. Because just the top four largest US banks represent 70% of US bank deposits, this "premature debiting" practice is in actuality a hidden fee or unfair "negative float" tax on nearly each and every transaction in America. The practice affects corporations through lost earnings credit on disbursements and individuals through increased Not Sufficient Funds (NSF) charges paid into overdraft.

The reason that Regulators should be successful in putting and end to the practice of "premature debiting" is because the Federal Reserve System's Reg. E already considers the act of posting and *the receipt of electronic files* for this purpose to legally constitute "presentment." The financial markets abhor a "double standard" and billions of dollars change hands *daily* based on the law of what constitutes this presentment. The safety and soundness of the US banking system depends on US consumers not losing faith in their financial institutions, therefore, Regulators must act quickly on this electronically accelerated posting issue to prevent a systemic loss of that faith.

PROPOSED RULE: AVAILABILITY OF FUNDS AND COLLECTION OF CHECKS (Regulation CC – 12 CFR Part 229)

In March of 2011 the Federal Reserve System published "Proposed Rule" changes in the Federal Register at the Government Printing Office (FR Doc No: 2011-5449), thereby requesting public comment. The final rule amendments to the availability schedule provisions are supposed to reflect the fact that ***"there are no longer any nonlocal checks."*** The Federal Reserve Board of Governors will soon have revised the model forms that banks may use in disclosing their funds availability policies to their customers to update the "preemption determinations." This will have important consequences for retail corporations. What follows are a few excerpts from the Regulation CC language which implemented the Expedited Funds Availability Act (EFA Act) and the Check Clearing for the 21st Century Act (Check 21 Act) that was supposed to have represented improvement to the process of clearing and settling for payment transactions. My comments and questions are offered between the sections. I believe that corporate treasurers will clearly see in these rules that bankers have successfully avoided a proper legal definition -- as in the Uniform Commercial Code (UCC) -- for what should constitute "presentment" of a check, since the advent of electronic banking technology has rendered the old paper check legal constructs obsolete. Corporations will find enshrined in the Fed's new Regulation CC the banker's right to take unfair advantage of their customers by simply offering funds availability that is obviously inferior to that which the bank actually experiences on the corporation's items. When the top four largest banks control over 70% of all US bank deposits, allowing them to agree between themselves to re-sequence debit transaction by the margin of one whole day, as these regulations do, is like an anti-competitive invitation to take unfair advantage of the customer.

Please bear in mind as you read these regulations that before October of 2004 (which saw the establishment of the Check 21 Act) banks competed with each other to offer prospective customers the lowest cost check processing and the most rapid funds availability possible. That is how they earned an account's business. Prior to 2004, bank's costs for clearing paper checks ranged from $0.02 for local "City Items" to $0.04 for "Fed Regional" or "out-of-district" items. Learjet speed transportation cost $0.01 per check on average. Today, in contrast, the per-item price for a "small" corporate account in Bellingham, Washington, at one of the largest US banks, is $0.33 per check. Before Check 21, a local "clearinghouse" item represented no presentment fee cost whatsoever to a member clearing bank. Furthermore, those member banks offered "immediate credit" or "fully investable funds" to their corporate depositors (meaning useable funds on the same business day as ledger credit) as late as 10:00 A.M. local time on the day of deposit, for all clearinghouse member's routing/transit numbers. The "corporate teller window" did not close for "on-us" items (drawn on that bank itself) until as late as 3:00 P.M. on that day, also for immediate credit, which generated earnings credits for corporate accounts. Back then, greater than 98% of all other types of items cleared on an overnight basis; only "Country Items" were too remote for "next-day credit." Today, the average per item price to a merchant to process an electronic debit card transaction is $0.48 per item. What follows is the specific regulatory language that has allowed banks to slow-down the funds availability that they offer their customers, and which enables the practice of Electronic Premature Debiting (EPD) to earn for those operationally sophisticated banks "one-banking-business-day's" interest income on virtually every deposit they receive.

"Section 229.12 Availability schedule. YOUR ABILITY TO WITHDRAW FUNDS ... if you make a deposit after (time of day) or on a day we are not open, we will consider that the deposit was made on the next business day that we are open."

Note that the "time of day" concept referred to the beginning of the next day's ledger credit, and these cut-off times have been getting earlier and earlier.

"IV. Section 229.10 – Next-Day Availability A. Business Days and Banking Days 2. If a deposit of a
[lsqbb]local[rsqbb] check were made on a Monday, the availability schedule [rtrif]generally[ltrif] requires that funds be available for withdrawal on the second business day after deposit. Therefore, funds must be made available on Wednesday regardless of whether the bank was closed on Tuesday for other than a standard legal holiday as specified in the definition of business day."

Notice that the "second business day after deposit" language depends on the above concept of a next-day's ledger credit deadline which could be 1:00 P.M. or even earlier, which effectively turns Monday afternoon into Tuesday for the purpose of starting the two-day clock running.

"D. 229.10(c) Certain Check Deposits

1. The EFA Act generally requires that funds be made available on the business day following the banking day of deposit for Treasury checks, state and local government checks, cashier's checks, certified checks, teller's checks, and ``on us" checks, under specified conditions.
'A. 229.14(a) In General
The EFA Act keys the
requirement to pay interest to the time the depositary bank receives provisional credit for a check. The [lsqbb]Board intends the[rsqbb] term interest [lsqbb]to[rsqbb] refer[rtrif]s[ltrif] to payments to or for the account of any customer as compensation for the use of funds, but [lsqbb]to[rsqbb] exclude[rtrif]s[ltrif] the absorption of expenses incident to providing a normal banking function or a bank's forbearance from charging a fee in connection with such a service. [lsqbb](See 12 CFR 217.2(d).)[rsqbb] Thus, earnings credits often applied to corporate accounts are not interest payments for the purposes of this section."

Notice that next-day credit is limited to special types of checks (neither corporate nor consumer accounts), and that "on-us" items used to have late afternoon immediate credit cut-off times, which have only recently become next-day, even though banks still charge processing fees in addition to the "negative" or "credit" float that they create.

"A. 229.16(a) General
The business day cut-off time used by the bank must be disclosed and if some locations have different cut-off times the bank must note this in the disclosure

and state the earliest time that might apply. A bank need not list all of the different cut-off times that might apply. If a bank does not have a cut-off time prior to its closing time, the bank need not disclose a cut-off time."

Note that the intra-day "business day" and the "ledger credit" cut-off times are the same conceptually, and corporate treasurers need to understand what is being applied, since huge amounts of money are involved with this distinction.

"... [lsqbb]8[rsqbb][rtrif]7[ltrif]. A bank that provides availability based on when the bank generally receives credit for deposited checks need not disclose the time when a check drawn on a specific bank will be available for withdrawal. Instead, the bank may disclose the categories of deposits that must be available on the first business day after the day of deposit (deposits subject to Sec. 229.10) and state the other categories of deposits and the time periods that will be applicable to those deposits. [lsqbb]For example, a bank might disclose the four-digit Federal Reserve routing symbol for local checks and indicate that such checks as well as certain nonlocal checks will be available for withdrawal on the first or second business day following the day of deposit, depending on the location of the particular bank on which the check is drawn, and disclose that funds from all other checks will be available on the second or third business day. The bank must also disclose that the customer may request a copy of the bank's detailed schedule that would enable the customer to determine the availability of any check and must provide such schedule upon request. A change in the bank's detailed schedule would not trigger the change in policy disclosure requirement of Sec. 229.18(e).[rsqbb]"

Corporations therefore need to continually monitor the funds availability that they are experiencing through the DDA account analysis system and formally request to be appraised of any funds availability changes. The "detailed schedule" can and will "vary" from the "policy disclosure," as you will see in the Section on "variation by agreement" below.

"D. 229.19(d) Use of Calculated Availability

1. A depositary bank may provide availability to its nonconsumer accounts on a calculated availability basis. Under calculated availability, a specified percentage of funds from check deposits may be made available to the customer on the next business day, with the remaining percentage deferred until [rtrif]the[ltrif] subsequent day[lsqbb]s[rsqbb]. The determination of the percentage of deposited funds that will be made available each day is based on the customer's typical deposit mix as determined by a sample of the customer's deposits. Use of calculated availability is permitted only if, on average, the availability terms that result from the sample are equivalent to or more prompt than the requirements of *this subpart."*

Calculated float is very complicated; it must be "more prompt" yet the ratios change constantly with deposit mix variations, which makes monitoring even more important to corporations.

[lsqbb]F. 229.36(f)[rsqbb][rtrif]D. 229.36(d)[ltrif] Same-Day Settlement

"c. Sorting of checks. A paying bank may require that checks presented to it for same-day settlement be sorted separately from other forward collection checks it receives as a collecting bank or returned checks it receives as a returning or depositary bank. For example, if a bank provides correspondent check collection services and receives unsorted checks from a respondent bank that include checks for which it is the paying bank and that would otherwise meet the requirements for same-day settlement under this section, the collecting bank need not make settlement in accordance with paragraph [lsqbb](f)(2)[rsqbb][rtrif](d)(3)[ltrif]. If the collecting bank receives sorted checks from its respondent bank, consisting only of checks for which the collecting bank is the paying bank and that meet the requirements for same-day settlement under this paragraph, the collecting bank may not charge a fee for handling those checks and must make settlement in accordance with this paragraph."

If there are no presentment fee costs ("expenses incident to providing a normal banking function ") involved between the banks, then how did the price to the bank's customer get as high as $0.33 per item?

"the time for settlement. (This return deadline is subject to extension under Sec. 229.30(c).) The settlement must be in the form of a credit to an account designated by the presenting bank at a Federal Reserve Bank (e.g., a Fedwire transfer). The presenting bank may agree with the paying bank to accept settlement in another form (e.g., credit to an account of the presenting bank at the paying bank or debit to an account of the paying bank at the presenting bank). The settlement must occur by the close of Fedwire on the business day the check is received by the paying bank."

If settlement must occur by the close of Fedwire (which is 4:00 P.M. local), and electronic transmission of "presentments" occur instantaneously, then how did the language: "the availability schedule [rtrif]generally[ltrif] requires that funds be available for withdrawal on the second business day after deposit" become the standard in Section 229.10 above? Was not electronic banking supposed to be faster than flying checks around in airplanes? If electronics is far quicker than Learjets then why are corporations subjected to funds availability that could legally be three banking days from the date the item was presented, in other words, inferior funds availability relative to what corporations experienced when paper check transactions were cleared physically as opposed to electronically?

"XXIII. Section 229.37 Variations by Agreement

8. A presenting bank may agree with a paying bank to present checks for same-day settlement by a deadline earlier or later than 8:00 a.m. (See [lsqbb]Sec. 229.36(f)(1)(ii)[rsqbb][rtrif]Sec. 229.36(d)(1)(ii)[ltrif].)
9. A presenting bank and a paying bank may agree that presentment takes place when the paying bank receives an [lsqbb]electronic transmission of information describing the check rather than upon delivery of the physical check[rsqbb] [rtrif]electronic collection item[ltrif]. (See Sec. 229.36[lsqbb](b)[rsqbb][rtrif](a)[ltrif].)"

If the funds availability schedule that must be disclosed to the corporate account "state the other categories of deposits and the
time periods that will be applicable to those deposits" in broad terms like "categories," then how will corporate treasurer's possibly know when its bank has agreed to pay items in exception to that general rule category? Does not the "variation by agreement clause" (contained within the Uniform Commercial Code as well) give competitor Payor and Presenting banks a huge economic incentive to cooperatively clear and settle for re-sequenced payment transactions through these individual bi-lateral agreement "variations" at the expense of their collective customers? Do not the Electronic Check Clearing House Organization (ECCHO) rules introduce the concept of an electronic "Notice of Presentment" which is distinctly different than a paper check, or its digitized image, or its substitute document, in a manner that deliberately creates negative float or credit float through demand deposit account "replenishment" (paid for by corporate customers on an accelerated basis) for the items that these variations represent?

"D. The Board expects to review the types of variation by agreement that develop under this section and will consider whether it is necessary to limit certain variations."

If banks are at liberty to decide to "pay" a corporation's checks if and when they want to, and to delay funds availability under the variation by agreement clause, then is the only means open to corporations to protect their collective earnings credits through the repeated request for disclosure of the extent of the EPD practice, since *"the bank must also disclose that the customer may request a copy of the bank's detailed schedule* ***<u>that would enable the customer to determine the availability</u>*** *of any check and must provide such schedule upon request?"*

If hundreds of billions of dollars in daily transactions, worth billions of hard earnings credit dollars annually to corporations, are at stake in this regulatory change, then what is the point of allowing "variations" or exceptions to be made that thwart the purpose of this regulatory action, which was to make <u>all</u> checks clear as though they were local? I submit to the reader that funds availability schedule delays which negatively impact corporate accounts, followed by accelerated posting of electronic "notices of presentment" of those exact same items -- which positively benefits only the two banks involved -- is exactly the unfair economic advantage that the ECCHO rule's bi-lateral agreement "variations" are presently exploiting, to the extent of billions of dollars in corporate damages, on behalf of the largest dozen US banks.

VARIATION BY AGREEMENT CLAUSE LEGAL ISSUES

1.) Does the *Doctrine of Implied Immunity* shield banks from class action and/or anti-trust prosecution by our court system in the present case under review, i.e., the use of the "variation by agreement clause" to avoid the Regulation CC mandate (at least for checks cleared through the Fed) that a check is legally considered paid upon the receipt of the electronic files that constitute the underlying check transactions?

2.) What is the role of the contemplated "Preemption Determinations" in the context of the *Doctrine of Implied Immunity*?

3.) If the Board of Governors of the Federal Reserve System were to modify the variation by agreement clause of Regulation CC, by limiting any or all variations to less than one banking business day, or in other words by prohibiting business day cut-off variations into another banking day's accounting ledger, then would the state's Uniform Commercial Code (UCC) also need to be changed in the same manner, to prevent state-chartered financial institutions from gaining a competitive advantage over nationally chartered banks, in this regard?

4.) Could the Board specifically limit the Electronic Check Clearing House Organization (ECCHO) "variation" under review, on grounds that ECCHO should not actually be considered a "clearinghouse" under either Regulation CC or the UCC since ECCHO does not provide settlement to banks (rule making bodies are usually considered trade associations)?

5.) Could the Board prohibit the ECCHO variations in question specifically by prohibiting the use of electronic "Notices of Presentment" for posting as debits to "on-us" Demand Deposit Activity (DDA) accounts on a banking business day other than the same banking day the original check, the digitized image of the original check, or the substitute document of the original check, was deposited?

6.) Could the Board prohibit Paying and Presenting Banks from collusion relative to the publication of funds availability schedules by requiring that variation agreements like the ECCHO "bi-lateral agreements" or "business practices agreements" be filed with the Federal Reserve System and thereby made available to the public through the Freedom of Information Act (FOIA)?

7.) Does the act of bi-laterally agreeing between banks to settle (for an "on-us" cashletter that in all other respects qualifies for classification as a "same-day settlement presentment") on the accounting treatment basis of 50% in today's immediate funds with 50% deferred-credit until the next banking business day -- instead of same-day credit with settlement "at par" -- constitute the conceptual equivalent of "non-par" banking, or payment on the basis of $0.50 on the dollar?

8.) Could the Board modify Regulation CC to state that all checks are legally considered "paid" upon the receipt of the electronic file or subdocument which replaced the original check, which must take the form <u>only</u> of either a legally constituted digitized image or a substitute document, and also state that ECCHO concept of electronic "Notices of Presentment" constitute neither class of item and are, therefore, prohibited for use in posting debits to DDA accounts?

9.) Do Federal Reserve Bank Examiners have access to a Fed-regulated bank's table of accounts and the balances associated with each underlying individual account?

10.) Are General Ledger "suspense account" balances classified as bank assets for the purpose of determining a bank's "Tier One" or "equity" capital adequacy standard under the Basel III accords?

11.) Would an intentional misrepresentation of Tier-One Capital by an EPD practicing bank's CEO therefore constitute a violation of existing securities laws?