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Via email transmission: regs.comments@federalreserve.gov

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

Ref: Docket Number R-1176

Dear Ms. Johnson,

Schroeder Walthall, L.L.P. a Houston based law firm which, during the course of practice, represents several financial institutions, respectfully provides the following comments regarding the proposed rule to amend Regulation CC and its commentary. Such rules are promulgated to implement the Check Clearing for the 21st Century Act ("Check 21 Act").

Our comments do not necessarily reflect the opinions or comments of our clients.

We offer the following comment the Board's proposal to require a returning bank to identify itself on the back of the check, rather than providing returning banks with the flexibility to indorse on the front of checks and to include additional information in their indorsements.

* Many customers receive image statements that show the customer only the front side of the check. The more information the customer can obtain from the front image, therefore, the more able the customer will be to identify the existence of a problem, the nature of the problem and the need to request the substitute, or original, check.

In addition, often indorsements reproduced on the back of the check are illegible and overwritten. The proposed rule anticipates the check's visual

size to be reduced in a substitute check, further complicating the process of interpreting the indorsements.

We believe that the information regarding a returning bank is too important to obfuscate. There would be a substantial benefit therefore in placing the returning bank's full indorsement and information on the front of the check.

We offer the following comments regarding proposed Section 229.52(a), and whether an ACH debit created using information from an original check or substitute check should be a payment request covered by the warranty protecting against second presentment.

*The warranty against second presentment is necessary because truncating the original check creates two or more demands for payment. This is true whether the truncation results in an electronic transmission, an ACH wire, or reconversion into a substitute check. We are unaware of any substantially similar warranties provided by Reg. E or U.C.C. Article 4A. We would not expect such warranties because the generation of duplicate payment orders is not contemplated by the applicable regulation or statutes.

* We observe that the warranties of a check which is truncated into an ACH wire are still necessary to complete collection. Warranties are provided in the processing of checks for collection to accommodate the large number of institutions which may be involved in processing. Warranties are used to protect the institutions in a system in which the maker is not readily available to authenticate the check during the process. Such warranties may not be necessary in the processing of most ACH wire transfers in which the sender uses a security device to authenticate the payment order and any third party system is considered the agent of the sender.

With the truncation of the check into an ACH wire, however, the warranties of the check take the place of the security device, to authenticate the check. Further, it is unlikely that any institution that handles the check before truncating, or the truncating bank, will be considered or legally bound as agents of the "sender." The check warranties must therefore be preserved through collection. As a result, it is correct to interpret the resultant ACH wire as an "electronic version of the original check."

We offer the following comments regarding proposed Section 229.54, concerning the time period for filing a claim for expedited recredit.

* We urge the Board to include in its commentary clarification that the 40 day time period runs from receipt of the substitute check, not the receipt of

the statement. This will affect the amount of time a consumer has to review his statement and advise the financial institution of a problem, in accordance with the Uniform Commercial Code Art. 4.406. If a consumer receives an image statement only, our understanding is that the consumer will have the 30 day period (or period adopted by his state) to review the statement and request a substitute check. After delivery of the substitute check, the consumer will have an additional 40 days to submit a claim for recredit. If a consumer receives substitute checks with his statement, he will have 40 days in which to advise the bank and submit the claim for recredit.

* We urge the Board to include in its commentary clarification as to the extent that the proposed regulations will preempt state law with regard to the 40 day time period. Some states have adopted U.C.C. Art 4. 406, but have extended the period in which a statement holder has to review and advise the financial institution, even up to 180 days. Will a consumer in such a state who receives substitute checks with his statement be limited to 40 days in which to advise the bank of a problem? We understand that a consumer who receives only an image statement and any business customer would continue to have the full period in which to advise the financial institution of a problem. In the alternative, would the consumer have 40 days to file a claim for recredit, but have any remaining period to advise the problem not limited to the substitute check? We believe the latter would be extremely confusing to explain and implement.

* We urge the Board to provide a rule, commentary or other guidance that would establish a minimum period of time during which the truncating bank would be required to store the original checks. We find no requirement to store the original checks in the law at the present time, and the availability of the original check makes handwriting analysis viable as evidence in forgery cases. We are concerned that the “sufficient copy” saved by the truncating bank will carry whatever flaws the substitute check carries and will be of little help in determining the validity of claims by consumers and business customers for any kind of check problem.

* We urge the Board in amending Reg. CC to consider a uniform system of redress for customers with respect to checks improperly charged or credited to accounts. We understand that this comment may be beyond the scope of this proposed rule and the ability of the Board at this time. We do not believe, however, that the use of substitute checks will create new problems for consumers. Yet, the 40 day recredit and the financial institution’s ability to reverse the recredit at any time in the future without demand first being made on the customer, establishes a procedure when the use of a substitute check is involved that is different than that available

when an original check only is used, when a consumer receives an image statement, or when a customer, not a consumer, is involved.
We applaud the effort to align the procedure in Subpart D with that provided for consumers in Reg. E. We note, however, that the use of the substitute checks appears much closer to the electronic representation of checks than it appears to resemble electronic submission of payment orders.

Perhaps our system should move towards a more uniform vision of payment processing, beginning with an initial payment order coupled with a security authentication device. Electronically, the device is the equivalent of a PIN; in a check, the device is the signature. Presentment in either case would carry along certain warranties from processing institution to processing institution, without agency unless appropriate. Rights of consumers or customers to redress would be the same, at least among the members of the same class of customer; rights among the institutions to enforce warranties and indemnities would be the same.

We offer the following as comments regarding proposed Section 229.54(c)(4), regarding the financial institution's right to reverse the recredit of a claim without limitation.

* We urge the Board to provide in its commentary clarification of the federal preemption of the U.C.C. and Reg. E statutes of limitation by the provision permitting the Bank to reverse the recredit at any time in the future. We submit that a limitless ability of the financial institution to recover against its consumer gives the ability to the bank to easily go after the depositor, rather than to seek redress elsewhere from other parties in the system that are protected by statutes of limitation.

The proposed regulation treats the right to reverse the recredit as if it is part of the debtor/creditor relationship of the bank to its customer, resulting in a right to set off. It is not. A mutuality of obligations will not exist in every case.

The use of electronic transmission and the reconverting to substitute checks creates a system in which one or more multiple parties may be liable. There are several scenarios in which the consumer is not the culpable party, where the paying bank suffers a loss, and where the claim may be valid; it was timely presented, the charge was improper, and the original check is needed to verify that the charge was improper.

We strongly urge the Board to point out in commentary that a reversal of the recredit is not available to the institution in a situation in which the

claim was valid, but nevertheless a loss occurs. In such situation, the financial institution must use traditional means to pursue its claims.

* For the same reasons provided above, we urge the Board to consider requiring demand be made on the consumer before the reversal of the recredit occurs. The proposed rule requires no notice until the business day following the reversal. The financial institution could protect itself as easily by notifying the consumer that the account was being frozen and that a reversal would be made. This would permit a consumer to at least notify the payees of recent checks, should the reversal create an overdraft. We urge the Board to take into consideration that the validity of the claim may be a fact question in a dispute, not a bona fide obligation of the consumer to the financial institution.

Thank you for the opportunity to provide comments. Please contact us to discuss, clarify, or answer any questions; we can be reached at the telephone numbers and addresses provided above.

Very truly yours,

SCHROEDER WALTHALL L.L.P.
By: Leonidas F. Walthall, P.C.

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