

UMACHA

7100 Northland Circle #212
Brooklyn Center, MN 55428

March 12, 2004

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

RE: UMACHA Comments on the Proposed Amendments to Regulation CC Docket # R-1176

Dear Ms. Johnson,

UMACHA appreciates the opportunity to comment on this VERY important proposed regulation. UMACHA is a regional payments Association that supports electronic payments, with a focus on the ACH, in Minnesota, North Dakota, South Dakota, Montana, the upper peninsula of Michigan, and parts of Wisconsin. We represent over 825 financial institutions within that region. This regulation and the law it comes from will affect virtually every financial institution, and customer of a financial institution, in the country. We hope the Federal Reserve considers our comments, and those of other stakeholders, with a focus on the significant impact this proposal will have.

UMACHA intends to comment on four particular parts of the proposed regulation. Those four are endorsements, how the ACH network interfaces with truncated checks, the length of the proposed disclosures, and the consumer re-credit process.

Endorsements (Sec. 229.35 & 229.38):

It is UMACHA's position that the more information a truncating or reconverting bank can available on a item, the less likely there will be a problem with that item. Therefore we recommend that when it comes to the depositary bank indorsement, it be required rather than just recommended. We recognize that the ANSI – X-9.37 proposed standard does not require it but we believe that if the Fed does, the proposed standard will be updated to include it.

ACH Entries and how the interface with Check 21 and Substitute Checks:

The Commentary to Section 229.2(zz) of the Proposal states that “[B]ecause a substitute check must be a representation of an item that is defined as a check under Section 229.2(k), a paper reproduction of an image of something that is not a check cannot be a substitute check.” UMACHA agrees that the Fed has taken the appropriate position with this statement but we believe further clarification concerning what the items is. Is the item an IRD (or a purported

substitute check – whatever that is) and therefore not covered by any regulation, or is it something else.

The ACH Network supports several applications where a check is truncated and used to initiate an ACH debit – i.e., Re-presented Check Entries (RCK), Destroyed Check Entries (XCK), and Check Truncation Entries (TRC or TRX). Up to and including the point of truncation, the “check” in each of these applications was negotiated in accordance with the Uniform Commercial Code Articles 3 and 4 (“UCC 3&4”).

UMACHA believes that the check used in these applications is covered by Regulation CC through the point of truncation. The resulting ACH entry is covered by the NACHA Rules and other relevant law or agreements. Consequently, the original check can be converted to a substitute check at any point up to the point of truncation, and an ACH debit can be initiated from the substitute check.

The ACH Network also supports applications where a check is used as a “source document” as part of the EFT authorization process – i.e., Accounts Receivable Entries (ARC) and Point of Purchase Entries (POP). In neither of these applications is the original check ever negotiated under the terms of UCC 3&4 and as such these applications should lie fully outside the scope of Regulation CC (they are covered by Regulation E).

There are circumstances when an ARC or POP entry is intended, but the check provided was either: (1) a type of check identified as ineligible as a source document under NACHA Rule 3.6.2 (for ARC Entries) or 3.7.1 (for POP Entries); or (2) the merchant or biller has in some way failed to obtain proper authorization for the transaction. In either circumstance, a payment obligation is incurred, but NACHA Rules prevent the payment from being collected as an ACH debit. Since the check used for either application is ineligible under the NACHA Rules as a source document, or its conversion has not been properly authorized, we believe the check has been negotiated under the terms of UCC 3&4 and therefore can be converted to a substitute check.

UMACHA further contends that this scenario exists whether the merchant or biller determines the check’s ineligibility as a source document for an ARC or POP entry at the point of acceptance, or if the entry has been inadvertently originated and subsequently returned due to its ineligibility. In the latter circumstance, NACHA believes that the merchant or biller would have the right, upon learning of the original check’s ineligibility as a source document, to rely on either the original check or the creation of a properly authorized demand draft (e.g., if the original check is unavailable), either of which could be converted to a substitute check, to collect the underlying debt.

Length of the Proposed Disclosures:

The disclosure in Appendix C is almost two and a half pages long. Other than a VERY small group of consumers, anything over a page in length will not be read making it less-than helpful. UMACHA suggests that the Fed reduce the size of the disclosure to no more than one page.

Consumer Re-Credit Process:

UMACHA recognizes that the timeframe for re-credit is part of the law and not the regulation but it would seem to make sense to try and standardize the timing with other, already existing regulations. Regulation E gives a consumer 60 days from statement date to report an error. It seems reasonable that Regulation CC would do the same. UMACHA recommends that the Fed use the Reg. E timeframe (which is more generous) thereby simplifying the process for consumers and financial institutions.

Remotely Created Drafts:

UMACHA's understanding from its members and from law enforcement is that unauthorized demand drafts are being used extensively to commit fraud against consumers and businesses. Demand drafts saddle paying financial institutions with significant costs and customer service issues when the authorization is in dispute and has to be researched. Moreover, collecting on an unauthorized demand draft is difficult for the payor and paying financial institution since the item almost certainly is not discovered until after the midnight deadline for its return has passed.

For these reasons, UMACHA strongly supports adding an authorization warranty for demand drafts to Regulation CC since this would clarify where the responsibility for obtaining proper authorization lies and which party(ies) would be accountable in the event of a disputed authorization. Moreover, by adopting such a warranty under Regulation CC, which we believe the FRB has the authority to do, the warranty would apply uniformly across the Nation's check collection mechanism, regardless of state or means of collection.

The UMACHA Check 21 Task Force has also asked that they be included as commenters along with UMACHA. The task force includes:

- Leo Stadnik – Independent Community Bankers of Minnesota
- Ellen Thompson – United Bank, Osseo, Wisconsin
- Bev Miller – First Interstate Bank, Billings, Montana
- Sean Sullivan – First National Bank, Brookings, South Dakota (chair)
- Dave Mickleson – First Premier Bank, Sioux Falls, South Dakota
- Brenda Brannan – North Shore Bank of Commerce, Duluth, Minnesota
- Carol Shaubach – Travelers Express, Brooklyn Center, Minnesota
- Kathy Jeanson – Rural American Banks, Roseville, Minnesota
- Michelle Steadman & Cindy Beals – Rocky Mountain Bank, Billings, Montana
- Fred Holzapfel – Anchor Bank, Apple Valley, Minnesota
- James Ramey – CFC Financial Services, Bloomington, Minnesota
- Shelly Doll – Stearns Bank, St. Cloud, Minnesota
- Julie Berglund – Bremer Banks, St. Paul, Minnesota
- Bonnie Peterson – First Federal Bank, Hutchinson, Minnesota
- Dale Newcomb – Merchants National Bank, Winona, Minnesota
- Shelly Eilers – First Dakota Bank, Yankton, South Dakota
- Margaret Nielsen – Lake Region Bank – New London, Minnesota
- Wendy Madsen – First National Bank – Sioux Falls, South Dakota

Request for Comment
Docket #1176
Page 4

Cindy Ochs – Corporate Credit Union, Hales Corners, Wisconsin
John Decker – Midwest Software Inc. Laurel, Montana
Wells Fargo Bank, US Bank, Heritage Bank in Willmar Minnesota, Minnesota Bankers Association, Electronic Check Alliance, The Minnesota Credit Union Network, Solutran, and Liberty Enterprises are also on the task force but did not participate when this request was made.

UMACHA appreciates the opportunity to comment on this proposal. If you have any questions regarding our comments please call me at (763) 549-7000 or e-mail me at fredl@umacha.org.

Sincerely,

Fred Laing, II
President