



MID-ATLANTIC
CORPORATE

Federal Credit Union

*A Financial Service System Exclusively
for Credit Unions*

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March 12, 2004

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

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

Dear Ms. Johnson:

Mid-Atlantic Corporate Federal Credit Union (“Mid-Atlantic”) would like to express our appreciation for the opportunity to comment on the proposed rule to amend Regulation CC and its commentary to implement the Check Clearing for the 21st Century Act (the “Check 21 Act”) and improve Regulation CC overall. Mid-Atlantic further applauds the Federal Reserve Board for thoroughly inspecting the proposal and for the extended comment period it offered on the rule.

Mid-Atlantic Corporate Federal Credit Union is a federally chartered corporate credit union that provides investment, lending and payment services, including ACH, share draft and electronic bill payment processing, to credit unions, CUSO’s and affiliated organizations in 38 states, the District of Columbia, and the Territory of Guam.

Mid-Atlantic further enjoys representation on the Credit Union National Association’s (“CUNA”) Payment Systems Subcommittee. Mid-Atlantic supports the letter of comment submitted to the Board of Governors of the Federal Reserve System by CUNA regarding the proposed changes discussed herein. Moreover, Mid-Atlantic shares much of the same views of CUNA’s Payment System Subcommittee as is reflected in the follow pages.

Legal Equivalence for Substitute Checks with MICR Errors

Mid-Atlantic strongly believes all substitute checks should be treated as the legal equivalent of the original check regardless of whether there is an error in the MICR line of the substitute check. This will ensure that a substitute check is a reliable, negotiable instrument.

Currently, the proposal would make certain MICR line errors a reason to deny the legal equivalence of a substitute check. By allowing this, the proposal introduces new liabilities into the check collection system and will create uncertainty regarding the handling of substitute checks. We believe that all substitute checks should be considered the legal equivalent of its original regardless of errors on the MICR line. Moreover, financial institutions should be given the same rights in handling substitute checks with MICR line errors as they are currently given with regard to the original.

The final rule should require a reconverting bank to print the MICR information from the original check on every substitute check that it creates. A failure by the reconverting bank to do so should be considered a breach of the Check 21 Act Warranties.

Encourage MICR Repair on Substitute Checks

Mid-Atlantic strongly believes that the reconverting bank, collecting bank and returning bank should be allowed to repair MICR line errors on a substitute check without invoking the check 21 warranties and thus incurring additional liability for consequential damages under the Check 21 Act. We also believe that the proposal should encourage collecting and paying financial institutions to treat and repair the MICR lines on substitute checks in the same manner that they would treat and repair original checks. As with original checks, these repairs should not be mandatory. If the collecting or paying financial institution repairs the MICR line of a substitute check incorrectly, they should incur the liabilities for breach of the encoding warranties under the Uniform Commercial Code (“UCC”) and Regulation CC.

By making a downstream financial institution liable under the warranties of the Check 21 Act, these institutions will be discouraged from making such corrections as they are doing today. We believe this will lead to an increase in errors at the consumer level that do not exist under current regulation.

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

Address Inconsistent Liability Among Reconverting Banks

Mid-Atlantic strongly supports amending the proposed regulation to create equivalent liability among the first and second reconverting bank, when the first reconverting bank does not provide notice that it is creating a substitute check. If the first reconverting bank does not properly encode position 44 of the MICR line, the second reconverting bank may not recognize the item to be a substitute check and thus the second bank may create an illegal substitute check by failing to preserve the size of the image of the original check. We believe that under the proposed regulation, the second reconverting bank would be liable for consequential damages as a result of an error by the first reconverting bank. The first reconverting bank would further be absolved of their breach of the warranties under Check 21. We request the Federal Reserve Board to amend the

commentary of the proposed regulation to state that the second reconverting bank will not bear liability for consequential damages due to an error by the first reconverting bank.

Eliminate Concept of “Purported Substitute Check”

Mid-Atlantic requests the elimination of Section 229.51(c) of the proposed regulation, which discusses the concept of a “purported substitute check”. We believe this section introduces uncertainty into the reliability of substitute checks.

Definitions and Standards

Mid-Atlantic supports including the new definition of “transfer and consideration” in the proposal. This will allow a paying financial institution to transfer a substitute check to its members or customers.

Mid-Atlantic believes that the Federal Reserve Board should refer to general industry standards in the regulation and reserve any discussion of specifics within these standards for the Commentary. This will allow the Federal Reserve Board to support an industry standard without having to amend its regulation beyond the Commentary when this standard is adjusted or changed at some point in the future..

Adopt “Banking Day”

Mid-Atlantic supports incorporating the usage of “banking day” in the proposal, as opposed to “business day”. By doing so, the regulation would be consistent with the timing in Regulation E.

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

Mid-Atlantic supports excluding duplicate ACH debit payments that originate from a substitute check from the Check 21 Act warranties. The NACHA Operating Rules provide proper protection for consumers under this scenario.

Consumer Disclosures

Mid-Atlantic supports the following items as they regard consumer disclosures:

- Shortening the consumer awareness notice to include only the basic information on substitute checks and expedited recredits, so that it is easier for a consumer to read.
- Including sample notices for the Check 21 Act notice requirements and specifying that the Federal Reserve Board deems usage of these, or substantially similar notices, as compliance with the Act.
- Eliminating the requirement to notify consumers in writing when a claim is valid. In these cases, the consumer will receive a recredit.
- Allowing financial institutions, which have not already provided disclosures, to provide a consumer awareness notice with the substitute check.

Unrelated Regulation CC Amendments

Mid-Atlantic requests that the Federal Reserve Board take the following comments into consideration as they regard unrelated Regulation CC amendments.

- Mid-Atlantic supports adopting a new Regulation CC warranty regarding unsigned, remotely created items, after the Federal Reserve Board develops a specific warranty that undergoes the rulemaking process. These new warranties should be similar to the warranties recently adopted by the National Conference of Commissioner on Uniform State Law for UCC Articles 3 and 4.
- Mid-Atlantic does not support the reduction of the time frames for notice of nonpayment. For checks in the amount of \$2,500 the time frames should remain as they are.
- Mid-Atlantic generally supports requiring disclosures in Regulation CC to be consistent with the requirements of the Electronic Signatures in Global and National Commerce Act (the E-Sign Act) and adopting language that clarifies the acceptability of e-mail.
- Mid-Atlantic supports the concept of defining “clear and conspicuous,” for purposes of notices under Regulation CC, after the Federal Reserve Board develops a specific proposal that undergoes review in a normal comment process. This proposal is not part of the Check 21 Act, and therefore is not subject to the time restrictions of Check 21. As a result, the Federal Reserve Board should present the public with the specific language, so that organizations can provide meaningful comments, before this language is implemented.
- Mid-Atlantic supports the Federal Reserve Board’s proposal to allow more flexible usage of notices. The Board proposes adding a sentence to the commentary to § 229.10 (c) to clarify that a special deposit slip notice need not be posted at each teller window, although it must be posted in a place where consumers are likely to see it before making a deposit.
- Mid-Atlantic supports the Federal Reserve Board’s proposal to define “local bank” more clearly.
- Mid-Atlantic supports clarification of the current rules regarding the extension of the Midnight Deadline. The proposed amendment to Regulation CC would make it clear that the check must be received by the returning bank’s cutoff hour for the next check-processing cycle.

Mid-Atlantic again thanks the Federal Reserve Board for providing the opportunity to comment on this proposal as well as the extended public comment period provided. Mid-Atlantic hopes the comments provided in this letter assists the Federal Reserve with adjusting and finalizing these proposed amendments. Mid-Atlantic also reiterates its support for the letter of comment filed by CUNA on behalf of the credit union industry

Sincerely,

Jeffrey M. Stoner
Vice President, Payment Services

Cc: Michelle Q. Profit, Assistant General Counsel, Credit Union National Association