THE NATIONAL CLEARING HOUSE
1999 Bryan Street, Suite 1500
Dallas, Texas 75201

May 2, 2005

By Electronic Mail

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

Re: Regulation J and CC; Docket No. R-1226

Dear Ms. Johnson,

The National Clearing House (NCHA) is a member-owned and member-driven national association of financial institutions. It is the single largest settler of check volume cleared in the United States, settling over 6.6 billion items annually representing over 55% of all checks estimated to be cleared in the private sector. NCHA provides check clearing, settlement and related services to over 550 check processing sites of its 274 members and members of eighteen Associated Clearing Houses across the country. Membership ranges from 17 of the 20 largest banks to hundreds of regional and community banks and credit unions. NCHA supports industry standards and continues to expand services through valuable partners and alliance in its commitment to promote image exchange and help the entire industry manage the transition. On behalf of its member institutions, The National Clearing House is pleased to submit its comments on the following.

I. Background. On January 1, 1996 the National Clearing House Association’s predecessor organization the Clearing House Association of the Southwest implemented a clearing house rule designed to reduce fraud from counterfeit and unauthorized signature checks. Parallel to the development of this clearing house rule, the Texas legislature enacted a new law related to “demand drafts.” Section 4.208(a) (4) of the Texas UCC adds a presentment warranty (partially reversing the rule of Price v. Neal) "(4) if the instrument is a demand draft, the creation of the draft according to the terms on its face was authorized by the person identified as the drawer."

Section 3.417(a) (4) contains a similar presentment warranty. A "demand draft" is defined in Section 3.104(k) of the Texas UCC as "a writing that is not signed by a customer, as defined in Section 4.104(a)(5), and that is created by a third party under the purported authority of the customer for the purpose of charging the customer's account with the bank. A demand draft does not include a check drawn by a fiduciary, as defined in Section 3.307. A demand draft may contain any or all of the following: (1) the customer's printed or typewritten name or account number; (2) a notation that the customer authorized the draft; and (3) the statement 'No signature required,' 'Authorization on file,' 'Signature on file,' or words to that effect."

Over the past year, The National Clearing House has been aggressively promoting to other clearing houses (in states that have not adopted demand draft legislation) the adoption of a clearing house rule (referred to as Rule 8) that shifts the liability for unauthorized remotely created checks (also known as unauthorized demand drafts) from the paying bank to the depositary bank. The goal of this promotional effort is to achieve industry-wide adoption of check fraud warranty clearing house rules across the nation so that all financial institutions can reduce check fraud losses. On behalf of the NCHA membership, and the goal to support standardization of rules, we support amending Regulation CC and Regulation J to include remotely created draft warranties and urge the Board to clarify to what extent, if any; clearing house rules and/or state law would preempt Regulation CC.

II. The National Clearing House Comments. We respectfully offer comments to the following issues raised in the Proposal.

a. **The definition of a remotely created check.** The Board's proposal defines "remotely created check" as a check that is drawn on a customer account at a bank, is created by the payee, and does not bear a signature in the format agreed to by the paying bank and the customer. This definition is similar to the definition of a demand draft. It would be important to clarify and confirm if a remotely created check and a demand draft are interchangeable terms. We urge the Board to use the definition of demand draft that has been in effect since 1996 and has been adopted and tested in over 25 states either statutorily or by clearing house rule.

"Demand draft" means a writing that is not signed by a customer that is created by a third party under the purposed authority of the customer for the purpose of charging the customer's account with a bank. A demand draft may contain any or all of the following:

(1) the customer's printed or typewritten name or account number;
(2) a notation that the customer or typewritten name or account number;
(3) the statement "No signature required," "Authorization on file," "Signature on file," or words to that effect.

b. **Prevalence and uses of remotely created checks.** Our members have not tracked and provided specific statistical data as to the number of demand draft claims they process. However, they have anecdotally reported an increase in claims during 2004.

c. **If it is appropriate to cover all remotely created checks or to follow the UCC approach of covering only remotely-created consumer items.** We find no clear business reason to make a distinction between business and consumer checks as they are both subject to fraudulent activity; therefore, we urge the Board not to differentiate between consumer items and business items. Most banks process items on high speed sorters and it would be difficult and non-cost effective to sort only for this distinction.

d. **Extending the midnight deadline.** NCHA supports the extension of the midnight deadline for up to 60 days with respect to unauthorized remotely created checks or demand drafts. Currently the practice is to return these claims on a “with entry” basis with banks which are bound by clearing house rule or are in a state that has passed related legislation. This extension allows financial institutions to receive funds immediately.

e. **Allow the State legislatures to adopt the UCC Amendments.** There are no guarantees that states would adopt UCC amendments in a reasonable time period or with the uniformity needed for the national industry. NCHA supports the adoption of the amendment to Regulation CC and Regulation J rather than wait for states to individually adopt legislation. Industry-wide standardization could serve to eliminate any incentive for criminals to set up operations in states that have not adopted the UCC warranty and also helps avoid differences that will result from individual state structured regulations.

f. **Implementation Period.** The experience of NCHA member banks is that banks need three to six months to prepare to implement this change. Banks need time to review their depositary agreements and correspondent relationship agreements as well as train their employees.

III. **Conclusion.** The National Clearing House wishes to express its appreciation for the opportunity to offer, on behalf of its membership, these comments. We urge the Board to consider the value of standardization for the national industry. Therefore, we urge the Board to adopt a standardized remotely created checks rule for all financial institutions and to specify that this rule preempts clearing house rules and state laws.

If you have any questions, please contact us.

Sincerely,

Fred Redeker
President and CEO

Cc: NCHA Board of Directors
NCHA Management Team
NCHA Check Fraud Steering Committee