



Credit Union National Association

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June 3, 2011

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

Submitted via [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Re: Regulation CC; Docket No. R-1409; RIN No. 7100-AD68  
Availability of Funds and Collection of Checks

Dear Ms. Johnson:

This comment letter represents the views of the Credit Union National Association (CUNA) regarding the Federal Reserve Board's (Board's) proposal to amend Regulation CC to increase next business day availability as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), and to encourage electronic check processing. By way of background, CUNA is the largest credit union advocacy organization in this country, representing approximately 90% of our nation's 7,400 state and federal credit unions, which serve about 93 million members.

CUNA supports efforts to improve efficiency in the payments system but has significant concerns with the proposal. While one of the proposal's objectives is to facilitate the further development of a fully-electronic check system, we have significant concerns that the proposal would substantially increase fraud-related and compliance costs if adopted. Our concerns and recommendations for improvement are addressed below.

### **Fraud Risk and Hold Periods**

We do not support the proposed decrease in the reasonable additional extension hold from 5 to 2 business days. Even when combined with the 2-day general hold, the reduced total exception hold period will likely increase check fraud risk and loss exposure to credit unions and other institutions. This is because more time is still needed for smaller institutions to handle problem items.



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We believe the Board should not reduce the reasonable additional extension hold period. If the Board must reduce the reasonable additional extension hold period, such a reduction should only be made if there is sufficient evidence that there is no undue increase in fraud risk and loss exposure and the Board cannot be assured such an increase in fraud-related costs will not occur if the hold periods are shortened.

Credit unions have noticed increased check fraud and losses in recent years, especially due to: (1) improvements in counterfeit technology; (2) decreases in hold periods with the elimination of non-local checks; and (3) increases in fraud involving cashier's checks and other next day availability items.

We do not agree that a depository institution (the first institution to which a check is transferred) will receive virtually all returned checks by the third business day after deposit, while the average time for returns has decreased because a higher proportion of returns are electronic returns. Credit unions, even those with electronic returns, report that a significant volume of checks are returned on the fourth business day or after. A depository institution is not able to control many of the delays in check processing and returns such as damage, misrouting, electronic image issues, batch processing problems, and human error, throughout different processes and intermediaries.

Another reason the Board should not decrease the reasonable additional extension hold is because the proposal would permit expeditious returns only if the institution agrees to receive electronic returns. Smaller institutions disproportionately rely on paper returns, have fewer resources to manage fraud risk and exposure, and will have to rely on the reasonable additional extension hold to mitigate fraud if they lose the right to an expeditious return.

In addition, for the approximately 22% of credit unions that use shared branching to provide more locations to serve their members and to ensure business continuity in the event of disaster, returns may be delayed. This is because if a shared branch outlet does not mark the depository credit union as the Bank of First Deposit (BOFD), the return would go to the shared branch outlet followed by an adjustment to the depository credit union.

While the Board projects that most checks in the system, as a percentage of total checks, will be returned electronically by the end of this year, there is still a significant volume of checks that will be returned by paper.

We encourage the Board to continue to work with credit unions and other institutions to obtain data on check fraud to account for changes in counterfeit technology and the payment landscape, such as the Board's

report on Check 21 fraud in 2007. Only after such a review should the Board consider reducing check hold periods. Also, any reduction of such check holds promulgated at that time should provide a sufficient transition period of at least 9 months to a year.

If the Board believes it is necessary to shorten the hold period, any reduction should be phased in gradually over multiple years to minimize fraud risk and loss exposure.

### **Dodd-Frank – \$200 in Next Business Day Availability**

We generally believe the approach to increase the threshold to \$200 for next business day availability is consistent with the new statutory requirement by the Dodd-Frank Act effective July 21, 2011. A depository institution must update its disclosures and provide a change-in-terms notice by August 21, 2011. However, we are concerned that the required increase in next business day availability would likely increase the dollar amount of losses associated with each instance of check fraud — even before the Board’s proposed reductions in hold periods or expeditious return requirements.

### **Expeditious Check Returns Limited to Electronic Returns**

We understand the proposed requirement that a depository institution would be entitled to an expeditious check return with the “two-day test” only if it agrees to receive electronic check returns, because a fully-electronic check system must have electronic forward collection, as well as electronic returns in order to maximize efficiencies, for all participants.

We urge the Board to provide appropriate data security guidance for the proposed electronic return requirements that is consistent with other data security regulations, which include electronic data and systems to be used by financial institutions.

The Board should clarify and provide additional guidance on the expeditious return requirements such as when a returning institution holds itself out as willing to accept returns from a paying bank and how a paying institution handles electronic returns when it is not able to identify the depository institution.

We believe that the proposed requirement that an expeditious check return limited to an electronic return would likely impose lower costs. The proposal also provides Alternative 1, under which a returning institution would be able to accept an electronic return from any returning institution or Alternative 2, under which an electronic return may be returned through the forward-collection chain. Neither Alternative should be adopted.

## **Deposits at Nonproprietary ATMs**

We do not support the proposed decrease of the total hold, which is the general hold and the reasonable hold extension, from 11 to 6 business days for deposits at nonproprietary ATMs. The proposal would decrease the general hold from 5 to 4 business days and the reasonable additional hold extension from 6 to 2 business days for deposits at nonproprietary ATMs. These deposit facilities present unique fraud risk and loss exposure, especially for credit unions. The additional hold periods on deposits at nonproprietary ATMs are necessary because ATM deposits often cannot be verified and are often in remote locations.

If the Board must reduce the total hold for deposits at nonproprietary ATMs, such a reduction should be made only if there is sufficient evidence that no undue increase in fraud risk and loss exposure will occur as a result of a shorter hold. Any reduction in hold periods should be phased in gradually to minimize fraud risk and loss exposure.

## **Notice of Nonpayment**

We do not support the proposed elimination of the notice of nonpayment (e.g., \$2,500 or more) because many credit unions use this type of notice to mitigate fraud. Even credit unions that use an electronic return may receive a notice of nonpayment earlier than an electronic return, which has helped reduce fraud.

Further, for the approximately 22% of credit unions that use shared branching, such credit unions may rely on a notice of nonpayment to mitigate fraud, especially if there is a delayed return if the shared branch outlet does not mark the depository credit union as the BOFD.

In addition, institutions that rely on paper returns will not be entitled to an expeditious return under the proposal, and these institutions should continue to receive a notice of nonpayment to mitigate fraud.

The Board should reconsider changes to remove the notice of nonpayment when virtually all depository institutions receive returned checks electronically.

## **“Reasonable Cause to Doubt Collectability” Hold Reason**

We ask the Board to provide further clarification, examples, and commentary on the “reasonable cause to doubt collectability” hold reason to account for suspected fraud and counterfeit checks. While the Board currently provides some examples that show a reasonable cause that the check may not be collectible for a specific check, we ask the Board to provide additional details that involve suspected fraud and counterfeit checks.

### **Case-by-Case Holds**

We support keeping case-by-case holds because some credit unions and other institutions that do not automatically hold deposited checks up to the statutory hold limits use such case-by-case holds to research the validity of the checks.

### **Funds Availability Notices by Email**

We generally support a notice of exception by email in the limited circumstance where the depository institution offers an email notification of funds availability by agreement and the customer has agreed to specifically accept an email notification of funds availability. In addition, an email notification of funds availability should satisfy the funds availability notice requirement without a separate notice of funds availability on paper.

However, a depository institution should not be required to provide an email notification of funds availability if the institution does not offer such a notice by email based on the institution's needs and policies.

### **Notice in Lieu of Payment**

We support keeping the notice in lieu of payment with the same information requirements for a notice of nonpayment, which provides notice to the depository institution that the check will not be paid, including to a depository institution that accept paper returns. We also recommend that a notice in lieu of payment include the MICR line of the original check, which provides useful identifying information.

### **“Refer to Maker” Return Reason Code**

We do not support the removal of or a limit on the “refer to maker” reason code to be used only in conjunction with another return reason code because institutions use this code to describe issues that another return reason code does not adequately describe. In addition, the removal or limit of the “refer to maker” code would likely deter a merchant from contacting a consumer who may be a victim of check fraud before a merchant seeks legal or other action against the consumer. Further, the removal or limit of the “refer to maker” reason code will likely involve significant costs and programming on existing systems.

### **Electronically-created items and Warranties**

The proposal requires that an institution that transfers an electronically-created item (i.e., item not derived from a check) as either an electronic collection item or return make the same warranties as a paper check, remotely-created, or substitute checks.

We generally believe that an electronically-created item should have similar warranties as paper checks, remotely-created, or substitute checks. We also believe that financial institutions may agree to vary the terms of the warranties to suit their needs.

However, electronically-created items are fairly recent developments and the Board should provide appropriate flexibility and risk management to account for any differences and unique risks with electronically-created items.

### **Same-day Settlement**

The proposal would permit paying institutions for same-day settlement to require electronic presentment of checks. We believe this requirement is consistent with the proposal's intent to encourage electronic returns. We also believe items presented for same-day settlement should be separated from other checks, which should improve the processing and identification of same-day settlement items. The Board, in its process to further define the regulations for same-day settlement, should provide appropriate flexibility and risk management on same-day settlement provisions.

### **Right to Charge-Back**

We support the inclusion of the depository institution's right to a charge-back after making funds available on the model disclosures. However, the Board should modify the proposed model disclosure language, which states that "if you withdraw funds from a check deposit, and the check is later returned unpaid, we may charge the check back to your account" to include the right to a charge-back when the check has been paid or another valid reason, which is permitted by the Uniform Commercial Code and applicable case law.

### **Qualifying Checks and Automated Return**

We generally support a continuation of qualifying paper checks by paying and returning institutions and a continuation of preparing a check for automated return by placing the check in a carrier envelope. Both processes should continue because alternative approaches will likely impose additional costs without significant benefit.

### **Provisions Related to "Nonlocal" Checks**

We generally support the Board's approach to eliminate the references to "nonlocal" checks and believe the approach is consistent with the consolidation of the Federal Reserve check-processing regions.

### **Deadline for Paying Institution to Initiate a Return**

The Board should not make changes at this time to decrease the time for a paying institution to initiate a return under Regulation CC. Paying institutions would likely incur significant costs without significant benefit if there is a decrease in the time to initiate a return. Instead, the Board should consider the impact of the numerous changes in this proposal before assessing whether any changes to a paying institution's deadline to initiate a return are necessary.

### **Model Forms and Disclosures**

We believe the proposed model forms and disclosures are generally consistent with the proposal. However, we urge the Board to minimize compliance costs and burdens by minimizing changes to the model forms and disclosures.

With respect to funds availability, we do not support the change to specify the date of funds availability instead of a number of days or other changes, which would likely require significant costs to implement. In addition, we are also concerned that the inclusion of the "total amount of deposit" in the funds availability notice would also require significant costs. While we do not support these types of changes, we ask the Board to provide additional flexibility and time if such changes are adopted.

### **Estimated Burdens and Costs**

We believe the Board's estimate of burden of 80 hours and \$5000 in net present value to convert to electronic returns understates the total costs of conversion. Institutions that convert to electronic returns will have significant costs to develop and adopt new model forms and disclosures, provide appropriate staff training, purchase software internally or at vendors, and implement the necessary processing changes. In addition, all depository institutions will likely have increased costs due to increased fraud if the proposed shortened hold periods are adopted.

### **Compliance Dates**

The proposal would provide a 12 month safe harbor for a credit union or other institution that uses the current model forms. The effective dates for the other proposed changes are: within 30 days for revisions to subparts A and B (definitions and availability of funds); within 12 months for proposed amendments to subpart B (availability of funds); and within 6 months for proposed amendments to subparts C and D (collection of checks and substitute checks, including the expeditious return changes).

We urge the Board to provide a delayed compliance date that is at least 6 months following publication of the final rule for the proposed revisions to

subpart A and B and at least 12 months for other changes, and to minimize the compliance costs and burdens associated with the proposal.

A delayed compliance date is especially important for smaller institutions that are attempting to comply with numerous other Dodd-Frank and regulatory changes, including the required changes to next day availability.

**Consumer Financial Protection Bureau (CFPB)**

As required by the Dodd-Frank Act, after July 21, 2011, the Board and CFPB will have joint rulemaking authority for provisions under the Electronic Funds Availability Act (EFAA) and Regulation CC, such as hold periods, exceptions to funds availability, and model forms and disclosures. We encourage the Board and the CFPB to continue to work with credit unions and solicit comments on the impact to credit unions during the rulemaking process.

Thank you for the opportunity to comment on this Regulation CC proposal. If you have any questions concerning our letter, please feel free to contact Senior Vice President and Deputy General Counsel Mary Dunn or me at (202) 508-6733.

Sincerely,

A handwritten signature in blue ink that reads "Dennis Tsang". The signature is written in a cursive, flowing style.

Dennis Tsang  
Regulatory Counsel