NACHA
The Electronic Payments Association®
13450 Sunrise Valley Drive • Suite 100 • Herndon, VA 20171
Phone: 703-561-1100 • Fax: 703-787-0996
eMail: info@nacha.org
www.nacha.org

May 2, 2014

Robert de V. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., NW
Washington, D.C. 20551

RE: Docket No. R-1409 and RIN No. 7100 AD 68, Regulation CC

Dear Mr. Frierson:

NACHA—The Electronic Payments Association[1] respectfully submits this response to the Board of Governors of the Federal Reserve System ("Board") on the proposed amendments to subparts C and D of Regulation CC ("Proposed Rule").

As a general matter, NACHA supports the Board's efforts to further facilitate the banking industry's transition to fully electronic interbank clearing. NACHA's comments to the Proposed Rule are limited to those that impact the ACH Network and to the legal interpretation of electronically created items.

Notice in Lieu of Return

NACHA appreciates the Board's thoughtful consideration of comments submitted in response to the Board's 2011 proposal to amend Regulation CC in its crafting of the Proposed Rule. For the reasons identified in NACHA's response to the Board's 2011 proposal, NACHA continues to support retaining an option for a paying bank to send notice in lieu of return since the electronic exchange and return of items has not eliminated the need for notice. Further NACHA supports the inclusion of MICR line information in the notice in lieu of return when that information is available as it can be helpful to the depository bank identifying the item to which the notice relates. Finally, along with other commenters to the 2011 proposed amendments to Regulation CC, NACHA also supports the Board's decision not to require use of the ACH Network for

[1] NACHA manages the development, administration and governance of the ACH Network, the backbone for the electronic movement of money and data. The ACH Network provides a safe, secure and reliable network for direct account-to-account consumer, business, and government payments. Annually, it facilitates billions of Direct Deposit via ACH and Direct Payment via ACH transactions. Used by all types of financial institutions, the ACH Network is governed by the fair and equitable *NACHA Operating Rules,* which guide risk management and create payment certainty for all participants. As a not-for-profit association, NACHA represents more than 10,000 financial institutions via 16 Regional Payments Associations and direct membership. Through its industry councils and forums, NACHA brings together payments system stakeholders to foster dialogue and innovation to strengthen the ACH Network. To learn more, please visit www.nacha.org, www.electronicpayments.org, www.payitgreen.org, and http://direct.nacha.org.

routing notices in lieu of return at this time as there is not sufficient industry support for the operational changes that would be required to enable that approach.

Electronically Created Items

In general, NACHA supports the proposed indemnity for electronically created items, subject to the modifications and comments set forth below. Providing such indemnity properly places the risk of loss arising out of such items on the institution introducing the items into the collection stream. NACHA continues to believe, however, that the proposed warranties at Section 229.34(a) are an appropriate supplement to the proposed indemnity even for electronically created items. A transferring or collecting bank should not be excused from making such warranties merely because there are challenges in making any of those warranties with respect to an item that was not created from a paper check. Instead of addressing such challenges through elimination of the warranty, it would be preferable to allow the warranties to be modified by agreement or clearinghouse rule so that all participants will have accepted the relevant variances from otherwise applicable warranties. This hybrid approach would give paying banks (and other banks in the collection stream) better protection against acceptance of items that they have no knowledge do not meet the generally applicable standards for electronic checks.

Similarly, incorporating electronically created items into the proposed indemnity provisions of subpart C of Regulation CC would fill an immediate need to protect a bank receiving against an electronically created item from another bank. The indemnity appropriately puts the risk of losses associated with such items not being derived from a paper check on the bank in the relatively better position to know that the item was not derived from a paper check and to protect itself contractually from such risk. NACHA believes that it is important for the Board to fill this gap so that institutions that introduce "electronically created items" into the payment system are made more clearly responsible for the losses those items can create.

In this regard, the Board has requested comment whether the losses covered by the foregoing indemnity should include losses experienced by the paying bank in connection with a violation of Regulation E. NACHA believes that actual losses experienced by the paying bank in connection with a violation of Regulation E should be indemnified by the transferring bank, which is in a better position than the paying bank to address this risk.

NACHA further believes, however, that the indemnity (and the warranty supported by NACHA above) should not be extended beyond the banks participating in the collection stream (for both forward and return items). The rights and obligations between banks and their direct depositing or drawing customers are the subject of agreements that vary from institution to institution and customer to customer. The balance of the protections that are provided by any particular institution to any individual customer should not be upset by a new set of generalized standards that do not take into account the full range of rights and responsibilities agreed between the parties. Rather, banks should continue to be permitted to contract separately with their customers for these protections while relying on the framework created by Regulation CC to backstop their obligations to their customers. By contrast, other banks in the collection stream have no ability to address these issues with drawer or depositing customers of other institutions.

Extending the proposed indemnity and warranty provisions to such customers therefore would substantially complicate the resolution of interbank claims.

NACHA interprets the Proposed Rule to apply to electronically created items only for purposes of the indemnity provided at Section 229.34(b) and that other provisions of subpart C of Regulation CC would not apply to electronically created items. However, NACHA is concerned that the Proposed Rule lacks clarity and could be interpreted such that electronically created items are a subset of electronic checks and electronic returned checks to which the provisions of subpart C of Regulation CC would apply. With the exception of the warranties in Section 229.34(a) as described above, the application of the remainder of subpart C of Regulation CC to electronically created items, in NACHA's view, would be inappropriate at this time. At present, the legal framework for electronically created items remains unsettled, and the simple incorporation of electronically created items into subpart C would give electronically created items functional equivalency with check before the significant outstanding issues regarding the risks created by such items have been addressed. Instead, NACHA encourages the Board to work with its sister agencies to more fully analyze the underpinnings and the risks of electronically created items, including the application of Regulation E to electronically created items in consumer transactions, before determining the appropriate steps to address gaps in the laws and regulations applicable to electronically created items.

To avoid an unintentionally overbroad interpretation of the application of subpart C of Regulation CC to electronically created items beyond the indemnity at Section 229.34(b) (and the warranty at Section 229.34(a), if modified), NACHA strongly encourages the Board to include in the final amendments to Regulation CC an affirmative statement that except for Sections 229.34(a), if modified, and (b) of the Proposed Rule, subpart C of Regulation CC does not apply to electronically created items. Other drafting changes could be made to further clarify the limited application of the Proposed Rule to electronically created items, such as (i) including a definition of "electronically created items" that is distinct from, and not included, in the defined terms "electronic check" and "electronic returned check"; and (ii) ensuring that all descriptions of electronic checks and electronic returned checks in the Proposed Rule and the related supplemental information and commentary consistently refer to the specific fact that they are "derived from" paper checks and not merely the broader term "related to" paper checks.

* * *

Again, NACHA appreciates the opportunity to provide comments on the Board's Proposed Rule. If you have any questions regarding our comments, please do not hesitate to call me at (703) 561-3943.

Sincerely,

/S/

William Sullivan
Senior Director and Group Manager
Government and Industry Relations

cc: Janet Estep, President, NACHA

Jane Larimer, General Counsel, NACHA
David Teitelbaum, Sidley Austin LLP