



April 30, 2014

Robert deV.Frierson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue NW  
Washington, DC 20551

via: [www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm](http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm)

RE: Docket No. R-1409; Regulation CC  
RIN No. 7100-AD68

Dear Mr. deV.Frierson:

Bankers' Bank Northeast (BBN) is pleased to submit a comment letter regarding the proposed revisions to Subparts C and D of Regulation CC, Availability of Funds and Collection of Checks. BBN recognizes that the Proposed Rule is extremely important and we applaud the Board for its efforts to continue the financial services industry's ongoing transition toward fully electronic interbank check collection and returns in order to provide a flexible and sound regulatory framework in the electronic check clearing process. Bankers' Bank Northeast, a state chartered, FDIC insured and Federal Reserve member bankers' bank located in Glastonbury, Connecticut provides correspondent services to over 200 federally insured financial institutions in New England and New York State. Seventy-seven of our client institutions are also investors in their bankers' bank. We service both community banks and credit unions.

Bankers' Bank Northeast is a participant in the Electronic Check Clearing House Organization (ECCHO) Industry Working Group's joint comment letter regarding the proposed changes to Regulation CC. In addition to our support of the Working Group's comments, the purpose of this letter is to further support the perspective of community banks and credit unions and to provide comments based solely on that perspective. While the 2013 Request for Comment to the proposed changes to Regulation CC is extensive and detailed, BBN is generally in support of the proposed changes as they will further update the existing regulation with the Check 21 Act and current industry standards for check image exchange. *The proposed changes, if finalized, will reflect the nearly complete electronification of check presentment and returns.*

BBN is in general agreement and support of the proposed changes as set forth by the proposal. It is our understanding that while this proposal to Regulation CC addresses several key components to further clarify the original proposal from 2011, the Board is also seeking a suitable solution for the handling of paper return items. In the 2011 proposal, many industry groups and individual financial institutions commented on the Federal Reserve Board's proposed approaches to the expeditious return rules. While electronic returns are prevalent and almost always meet the expeditious return rules, paper returns still exist within our current environment. The Board

is requesting comments regarding two new proposed alternative options for the handling of electronic and paper returns expeditiously. Both alternatives are intended to encourage electronic returns over paper returns. Bankers' Bank Northeast offers these additional thoughts, comments and concerns in regards to the proposed alternatives for expeditious returns and various other highlighted proposals:

Section 229.31(b) – Paying bank's responsibility for return of checks and notices of non-payment – No Expeditious Return Requirement – Alternative One

In alternative 1, the Board is proposing to eliminate the expeditious return test all together for both the paying bank and returning bank. The general idea is that we have achieved expeditious return for the vast majority of the items as a result of the electronic image exchange environment today. And as a practical matter, we should not need the expeditious return test. Alternative 1 proposes:

- Paying bank remain subject to the UCC midnight deadline for returning checks, by midnight of the following business day
- The Returning bank would remain subject to the UCC requirement to move items in ordinary care to BOFD.
- Under this proposal, there would be a new requirement imposed on paying banks and that is when they send the item as a return in paper form such as a substitute check, they would have to provide an electronic notice to the depository bank that the check is being returned, regardless of the dollar amount of the check. If a paper check is being returned, a notice must be sent to the depository bank. It is important to note that the notice of non-payment requirement must be received by the depository bank by 2:00 pm versus the current regulation delivery time of 4:00 pm.
- Imposes no expeditious return option by eliminating the expeditious return requirement for both the paying bank and returning bank regardless of whether the item is returned as electronic or in paper form.

**We contend that Alternative One would not achieve either the goal of migrating remaining paper return BOFDs to an electronic return channel or achieve the goal of ensuring that existing electronic returns from the paying banks to BOFDs remain in the electronic channel. This alternative neither requires the expeditious return rule by the paying bank or the returning bank nor does it require that all banks in the return channel, including the BOFD use an electronic return route. Without either of these requirements we are concerned that Alternative One:**

- Does not impose sufficient incentives on the BOFD
- Could result in slower return of checks
- Expeditious return test should not be reliant on notices – however it is important to note that many financial institutions are of the opinion that there is a need to maintain a requirement for high dollar item notification of non-payment for all items (paper and electronic returns) to protect the BOFDs from a loss in high dollar item situations.
- Notice requirements on the Paying bank only when returning paper will not be sufficient to protect electronic return enabled BOFDs.

Section 229.31(b) – Paying bank’s responsibility for return of checks and notices of non-payment – Expeditious Return Requirement – Alternative Two

In alternative 2, the Board is proposing that if paying banks and returning banks are permitted to send returned checks to depository bank or to any other bank to handle returned checks by agreement would be compliant with the expeditious return test. Paying Banks would always need to know whether or not an electronic return arrangement was in effect with a particular BOFD either directly or indirectly through a number of exchange relationships. This operational complexity will make it very difficult for a paying bank to determine its responsibilities to a particular BOFD for expeditious return and whether or not the paying bank has met its responsibilities in accordance with the regulation.

Alternative 2 is also proposing exceptions to the expeditious return test. There is no expeditious return obligation on the paying bank if the paying bank does not have an agreement to send electronic return checks. Therefore, if the paying bank is subject to the expeditious return, the paying bank can meet this obligation by either returning the paper check or electronic return check provided it does so expeditiously. This means the depository bank, as a result of this exception, is not entitled to expeditious return from any paying bank unless it has agreed to accept electronic return checks. In addition, if you are or happen to need to send a paper return (substitute check) the return will not meet the expeditious return test.

BOFDs are in the best position to take steps to ensure that they will receive returns expeditiously of all or most of their forward items. We anticipate that when a BOFD implements the requirements under Alternative 2 as proposed that the BOFD will maintain at least one connection for electronic return to any returning bank in order for the BOFD to be eligible and comply with the expeditious return test requirement.

Alternative 2 is a much more complicated test to apply as proposed:

- Imposes conditional expeditious return option - this conditional expeditious return option could impose operational and complex difficulties for a paying bank. The status of an electronic relationship is particularly difficult for a paying bank to determine.
- If an electronic path is available, paying bank/returning bank is subject to the expeditious return requirements for all items (paper and electronic) and the current 2 day expeditious return test applies thus eliminating the 4-day forward collection test since all exchanges are now considered local (as a result of the Federal Reserve having one check processing site).
- Moves the cutoff for the Depository bank’s receipt of the returned check from 4pm local time to 2pm local time on the second business day following the banking day on which the check was presented to the paying bank.
- Current Notice of non-payment is eliminated for items of \$2,500 or more.

**We contend that Alternative Two is a more acceptable alternative as compared to Alternative One. This alternative encourages paying and returning banks to return items within the electronic return channel. Any financial institution that does not have an agreement to process and accept electronic returns, will not be entitled to expeditious**

**return and essentially could increase financial risk. However, we have the following concerns with regard to this alternative as proposed and strongly request that the Board consider further modifications to the expeditious return requirement:**

- Lack of incentive to encourage migration to move to electronic return especially for those institutions with a relatively small number of items. It will also be complex and operationally difficult to establish multiple electronic arrangements.
- Unpredictability of Return Timeframes for BOFD with multiple return channels has the potential for exposure to risk of a non-expeditious return from a paying bank that does not have a direct electronic return arrangement with any of the returning banks used by the BOFD. Again, the paying bank really has no way of knowing who a particular bank is or is not connected to. A paying bank may face operational challenges to monitoring/determining whether or not there is electronic return arrangement to a particular paying bank available.
- Removal of the notice of non-payment for items over \$2,500 places an inappropriate amount of financial risk on the BOFD that has made a reasonable effort to maintain sufficient electronic return channels. As stated with regard to alternative 1, financial institutions are of the opinion that there is still a need to maintain a requirement for high dollar item notification of non-payment for all items (paper and electronic returns) to protect the BOFDs from a loss in high dollar item situations.
- Addition of Notice of Nonpayment requirement on a paying bank that is applicable to only paper items would not improve Alternative 2. To require the paying bank to provide notice to a BOFD in regards to a paper return allows the BOFD to take action to protect itself from losses and as such would see no urgency to move toward electronic. This aspect of Alternative 2 would further remove incentives especially for the smaller banks with relatively low return item volume to sign up for electronic returns which is in essence the purpose for either of these alternative return requirements. As stated previously, the requirement to provide a notice of non-payment for paper items would not be sufficient to protect a BOFD that is otherwise enable for electronic returns.

In conclusion, regarding the alternatives proposed for expeditious return requirements, we strongly recommend that the Board consider the sunset of paper returns within a designated time period thus allowing the remaining paper return institutions sufficient time to establish an electronic connection for the handling of returns expeditiously. Each of these alternatives has more of a negative impact on those financial institutions that are already returning items through electronic channels expeditiously. It is not clear that either of these alternatives offers enough incentive to migrate the remaining paper returns to electronics and will only enforce additional regulatory burdens on those already receiving electronic returns. By mandating a complex alternative many low volume institutions may be willing to face financial risk of late returns so as to avoid the obligation to determine the proper returning bank channel for an electronic return to the BOFD. Additionally, they may not be willing to undertake the cost of operational changes necessary to implement and monitor electronic returns and electronic return channels thus not achieving the goal as set forth by the proposed changes to Regulation CC for the expeditious return requirement. Mandating either of these alternatives will have no effect on the vast majority of return items as they are already handled electronically. Changing or eliminating the large dollar notification will increase the risk of losses to those institutions

that rely on the notice to “hold” funds prior to actually receiving the return check. We strongly recommend that the Board not eliminate or change the large dollar notifications process for either electronic or paper items as this notification has proved beneficial for those that take advantage of it. By sun-setting paper returns the industry would achieve a full electronic return environment. A full 100 percent electronic return environment would speed the overall return items process, reduce financial risk to the check system and depository institutions and their customers arising from slow paper return process and eliminate the costs associated with managing and maintaining separate paper return channels in order to reach all BOFDs expeditiously.

Section 229.31(e) – Paying bank’s responsibility for return of checks and notices of non-payment – Identification of Returned Checks – Commentary

We support the new proposed amendment to require the paying bank place the return reason on the “front” of the returned check and that for electronic returns the return information be included in a manner so that the information would be retained on any subsequent substitute checks. This proposed approach conforms to how the industry is handling the placement of returns reason codes under the current X9 industry standards formats as well as conform Regulation CC to current operational procedures.

We strongly support the decision by the Federal Reserve to continue to support the use of the “Refer to Maker” return reason code even under the limited use restrictions rather than totally eliminate the “Refer to Maker” as was originally proposed in the 2011 Request for Comment. The Refer to Maker Return reason may be the most appropriate reason to use where the paying bank cannot make a determination of a more specific reason between two or more conflicting return reasons such as fraud, possible counterfeit or altered items. We strongly agree the use of Refer to Maker should not be used in a situation involving duplicate presentment. However, we recommend that the Board not establish strict prohibition on the Refer to Maker reason. The industry may need the use of this return reason code in a situation where they have insufficient information to form a conclusive view. In certain situations it may be the most appropriate reason to use especially if a possible duplicate presentment is suspected. However, no other return reason codes are singled out within the context of Regulation CC. We believe that return reasons including the “Refer-to-Maker” return reason be addressed in the context of check industry standards and operational practices and not within regulation.

Section 229.34(a) – Warranties and Indemnities – Rule

We strongly support the content of the proposed electronic check warranties. To the best of our knowledge they are consistent with the approach to the electronic check warranties as prescribed in regulation J, ECCHO rules and bilateral agreements that exist today. We also support the approach that permits banks to vary the application of these new warranties to those banks participating in electronic exchange and with respect to the banks’ depositing and drawer customers. The ability to vary warranties allows banks flexibility to support the processing of check images that may not always conform to industry standards.

We strongly disagree with the proposal to extend electronic check warranties made by an exchanging or returning bank to the drawer customer on the forward side and the depositing customer on the return side. The concern here is that by extending these warranties the bank customer will have the ability to make a breach of warranty claim against banks that are not otherwise directly affiliated with the customer. The relationship of the customer and the Bank should be governed by applicable law and the deposit account agreements between customer and the bank and the customer should pursue any claims it has with respect to a particular item directly against the bank holding its account. In this regard, the account holding bank would satisfy its' direct customer and then pursue the other bank on the claim. The account holding bank is almost always going to be a necessary party in a dispute so why complicate the situation by allowing the drawer or depositing customers to bring breach of warranty claims against other banks in the forward or return collection process of electronic items. By limiting the application of these warranties to apply only between the account holding bank and its' direct customer does not complicate the inter-bank warranty process or expose banks other than the account holding bank to potential direct liability to account holding Banks's customers.

Section 229.34(b) – Warranties and Indemnities – Indemnity with respect to an electronic image or electronic information not related to a paper check (ECIs)

We support the approach in the proposal to provide protection to each bank that transfers or presents electronic image or electronic information not derived from paper check, indemnifies each transferee bank, any subsequent collecting bank, paying bank and any subsequent returning bank against any loss, claim, or damage that results from the fact that the electronic image or electronic information was not derived from a paper check in the event that the exchange of ECIs causes a loss to the paying bank that would have not arisen had an electronic check created from paper been exchanged between parties.

We would encourage the Board not either directly or indirectly to prohibit banks from exchanging ECIs in the future. While ECIs are not currently a widely offered “check product” there are efforts underway to consider the possibility that a form of ECI may be developed.

Section 229.34(g) – Warranties and Indemnities – Truncating bank indemnity – Rule

We support the initiative to propose a new indemnity to provide protection to any truncating depositary bank would indemnify another depositary bank that accepts the original check for deposit for that bank's losses due to the check having already been paid. This would allow a depositary bank that accepts the deposit of an original check to recover directly from a bank that permitted its customer to deposit the check through remote deposit capture (RDC). With the growth in consumer remote deposit capture there has been an increase in duplication presentment or electronic checks occurring in the context of remote deposit capture. This new indemnity is a step in the right direction as it provides the BOFD which received the paper check for deposit with a claim against the truncating bank whose RDC customer failed to control the paper check. It is our opinion that it is reasonable to impose the loss on the truncating bank which was best positioned to control the subsequent deposit of the paper check by its customer.

Section 229.36(f) – Presentment and Issuance of Checks – Same Day Settlement – Rule

We strongly encourage the Board to consider phasing out and sun-setting paper same day settlement. With the migration to electronic check clearing of checks there are very few financial institutions that are equipped or even prepared to handle any volume of paper cash letters. Receiving SDS items as paper creates additional processing complexity for image enabled community banks. Even with today's almost 100% electronic exchange environment, the development of an electronic SDS rule would create challenges. First, all electronic exchanges are predicated by agreements between the two banks which outlines the technological and operational elements and requirements. These technological requirements do not exist in the paper SDS world. To mandate electronic SDS by regulation would only be advantageous to the larger banks who have the infrastructure to develop, maintain and manage multiple electronic connections at a reasonable cost. Given the unique nuances of the technological and operational design of each electronic connection could in fact leave the smaller financial institutions at a competitive disadvantage. By having to accept a direct electronic SDS file from several different financial institutions small institutions would suddenly require an extensive infrastructure making the costs far outweigh any benefits at all. Since existing electronic exchanges "in essence" are a form of electronic SDS it is strongly recommended that the Board continue to allow the parties who wish to exchange electronically do so by agreement rather than mandate by regulation.

Section 229.36(f) – Variation by Agreement

We recommend that the Board should not prohibit or otherwise limit through a mandate of Regulation CC the ability of banks to vary by agreement any of the provisions of Subpart C in regards to electronic exchange relationships. If two parties are in total agreement of the variation then they should be allowed to enforce it between themselves providing that it is each bank's sole responsibility to act in good faith and exercise ordinary care. The regulation should provide guidance for a disclaimer regarding limitation of damages in the event that either party violates the agreement.

Section 229.52(a) – Substitute check warranties-Content and provision of substitute-check warranties– Rule

We support the amendment to provide that a depository bank that rejects a check submitted for deposit and returns a substitute check to the customer makes Check 21 warranties and provides indemnification regardless of whether or not the bank receives consideration in connection with the item. This revision/clarification permits the depository bank to provide a legally equivalent substitute check to its customer in a situation where the original check may have been truncated, such as at an ATM, but there is no other forward exchange of the image or substitute check. We fully support the implementation of this clarification on the application of the Check 21/Regulation CC warranty and indemnity for substitute checks.

Additional Issues for Comment:

Effective Date - We strongly recommend to the Board that a delayed effective date for the Final Rule of at least a minimum of six (6) months from the publication of the final rule be considered.

Definition of Remotely Created Check (RCC) - The current definition of “remotely created check” in Section 229.2 (fff) is overly broad, and includes items that may have been created by the account holding customer, such as an unsigned draft printed on a customer’s home printer. It also includes inappropriately unsigned drafts that are created by a bill payment company or the paying bank that the account holding customer instructs to make a payment to payee. When a remotely created check is created by a bill payment company or a paying bank, acting at the instruction of the account holding customer, to make a payment to a payee, the payee and the BOFD have no control over or involvement in the creation of the RCC, have not requested an RCC for payment, and may not even realize that the received item is an RCC, and therefore the BOFD, in these instances, should not be required to make the warranty of customer authorization for the RCC under Section 229.34.

Therefore, we recommend that the Board provide greater clarity in regards to the definition of a Remotely Created Check (RCC). We suggest that a remotely created check be defined as an item that does that does not contain the signature of the drawer and was created by the payee or the agent or service provider of the payee. A revised definition of remotely created check should exclude an item that does not contain the drawer’s signature but was created by the account holding customer (the purported drawer) or the customer’s agent or service provider (including potentially the paying bank), other than the payee or the payee’s agent or service provider. A more clear definition will bring with it the types of items that are generally the source of consumer disputes regarding authorization.

Presumption of Alteration - We support the addition to Regulation CC of a presumption of alteration in the event that there is insufficient evidence to determine whether or not a particular check image was altered or is a counterfeit item. There is a value to having a predictable and uniform national rule for the resolution of this type of dispute.

Bankers' Bank Northeast appreciates the opportunity to comment on this important proposal. Please do not hesitate to contact me, Elissa G. Reynolds, Senior Vice President / Operations and Service at [egr@bankersbanknortheast.com](mailto:egr@bankersbanknortheast.com) (860-657-4926) or Crystal Sides, Senior Vice President / Enterprise Risk Manager at [cs@bankersbanknortheast.com](mailto:cs@bankersbanknortheast.com) (860-633-5280) with any questions regarding these comments. Thank you.

Sincerely,



Elissa G Reynolds  
Sr. Vice President, Operations