May 2, 2014

Mr. Robert deV. Frierson
Secretary
Board of Governors of the
Federal Reserve System
20th and C Streets, N.W.
Washington, DC 20551

Re: Docket No. R-1409 / RIN No. 7100 AD 68:
Regulation CC – Availability of Funds and Collection of Checks –
Proposed Amendments

Dear Sir:

The undersigned financial services organizations (the "Commenters") are pleased to submit this joint comment letter to the Federal Reserve Board (the "Board") regarding its proposed revisions to Regulation CC (the "Proposed Rule"). Additional information regarding these five organizations is included at the end of this letter.

Our comment letter includes two attached documents. Attachment A to this letter sets forth our comments regarding the two Alternatives proposed in the Proposed Rule for replacing the current expeditious return rule. We also discuss in the Attachment A document our recommended revisions to Alternative 2 and our proposal for the eventual phase-out of paper return. Attachment B to this letter contains our comments to the other sections of the Proposed Rule.

To review the Proposed Rule and prepare this comment letter, the Commenters organized a working group (the "Working Group") composed of financial institutions from our respective memberships as well as other financial services industry participants, such as networks, processors and payments associations. The Commenters and the Working Group developed the comments set forth on the Attachments.

The Commenters spent a significant portion of our time on this Regulation CC project discussing and considering the two Alternatives for the expeditious return rule that are proposed by the Federal Reserve in the Proposed Rule. The Commenters recognize that the proposed change in the expeditious return rule under Regulation CC will have a significant impact on the how the check industry operates in the coming decades, and as such we and our member financial institutions carefully considered potential operational and legal impacts of these two Alternatives.

The positions and comments in this letter, while based upon input from our respective member financial institutions and others, ultimately represent the views of the Commenters. We expect that some of our respective member financial institutions may submit separate comments taking different positions regarding one or more issues raised by the Proposed Rule. In addition, one or more of the Commenters also may submit separate comment letters with comments and views specific to their organization and membership.

Thank you for this opportunity to provide our comments to you regarding the Proposed Rule. If you have any questions regarding this letter, please do not hesitate to contact one of the undersigned representatives of the Commenters.

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Information Regarding The Commenting Organizations

American Bankers Association

ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets.

The Clearing House Payments Co., L.L.C.

Established in 1853, The Clearing House is the oldest banking association and payments company in the U.S. It is owned by the world's largest commercial banks, which collectively employ over 2 million people and holds more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing house, funds-transfer, and check-image payments made in the U.S. *See* The Clearing House's web page at www.theclearinghouse.org.

ECCHO

ECCHO is a not-for-profit national check clearinghouse owned by its over 3,000 member financial institutions dedicated to promoting electronic check collection and related payment system improvements. ECCHO is recognized across the U.S. as the national provider of private sector check image exchange rules. During 2013, ECCHO member financial institutions used check images to exchange under the ECCHO check clearinghouse rules approximately 8.9 billion transactions totaling $13.0 trillion. See ECCHO's web page at www.ECCHO.org

Financial Services Roundtable

As advocates for a strong financial future™, FSR represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

Independent Community Bankers of America

The Independent Community Bankers of America® (ICBA), the nation's voice for more than 6,500 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. ICBA members operate 24,000 locations nationwide, employ 300,000 Americans and hold $1.3 trillion in assets, $1 trillion in deposits and $800 billion in loans to consumers, small businesses and the agricultural community. For more information, visit www.icba.org.

ATTACHMENT A

Working Group Comments to the Federal Reserve Regulation CC Proposal

This document sets forth the Working Group's comments regarding the Proposal's proposed approaches to revise the expeditious return requirements of Regulation CC. This document sets forth comments and suggested revisions to Alternatives 1 and 2 and describes a proposal for the phase out of paper return in the U.S. check system. Additional Working Group comments to the Proposal are included in the chart at Attachment B. Individual members of the Working Group may submit separate comment letters taking different positions regarding one or more issues raised by the Proposed Rule.

1. Comments to Alternative 1

General Comment on Alternative 1. The members of the Working Group identified a number of concerns regarding the Alternative 1 approach for expeditious return, and as a result the Working Group does not support the adoption of this Alternative in the final rule. In summary, the Working Group is uncomfortable with this Alternative because it neither requires expeditious return by the paying and returning banks nor requires that all banks in the return channel, including the bank of first deposit ("BOFD"), use an electronic return route. Without one of these two requirements in a return rule, the Working Group is concerned that Alternative 1 would not either achieve the goal of migrating the 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 an electronic return channel.

Alternative 1 Does Not Impose Sufficient Incentives on the BOFDs. The Working Group is of the view that Alternative 1 does not place sufficient incentives on the BOFD to sign up for electronic return. It is the Working Group's understanding that a BOFD that is not signing up for electronic return typically has a relatively small return volume. Under Alternative 1, this type of BOFD would obtain notice of return from the paying bank for some or all of the items that are returned to it. The combination of notice of return for some or all of the returns, and a relatively low overall number of returns, may still lead a BOFD with relatively small return volume to conclude that there is insufficient risk of financial loss (from a late return) to sign up for electronic return (i.e., this notice requirement is sufficient to address the BOFD's financial exposure from slow return).

Alternative 1 Could Result in Slower Return of Checks. Participants in the Working Group are concerned that Alternative 1 could result in slower return of checks to the BOFDs as a result of intentional and unintentional responses by paying banks and collecting banks to a final rule that included Alternative 1. For example, a returning bank may see Alternative 1 as an opportunity to offer paying banks a cheaper return service that involves electronic return from the paying bank to the returning bank but then a paper return or a multi-step, i.e. slower electronic return

from the returning bank to the BOFD. A second example of a potential slower return that may result under Alternative 1 is where a paying bank uses Returning Bank A to handle an electronic return, but the paying bank is not aware that Returning Bank A will convert the electronic return to a paper return. Had it known how Returning Bank A would handle the return, the paying bank would have used Returning Bank B that had a complete electronic return channel to the BOFD. In this case the BOFD may receive non-expeditious return and no notice of non-payment.

Notice Requirements Will Not Protect Electronic Return Enabled BOFD Where Returning Bank Drops Return to Paper. The Working Group concluded that the notice requirement on the paying bank only when returning a paper check would not be sufficient to protect a BOFD that is otherwise enabled for electronic return for most or all of its returns from returning banks and paying banks. In particular, under Alternative 1, the BOFD would have no notice that a returned item is being handled as a paper return, if the paying bank starts the return as an electronic return to the returning bank, but the returning bank converts it to a paper item. As discussed in the prior paragraph, there could be situations where the returning bank drops an electronic return to a paper return for pricing, product or other reasons, and the BOFD would then have no notice that the paper check return option is being used. This could be the case even when the BOFD is otherwise accepting electronic returns from many or all of the return channels.

To address this lack of a notice obligation on the returning bank that sends a paper return check to a BOFD, the Working Group considered whether the final rule should impose a notice requirement on the returning bank if it converts an electronic return to a paper return. However, the Working Group identified two problems with such a requirement. First, it is likely that this notice would be burdensome on the returning banks that are not experienced today with the use of notice of high dollar returns. It also would be difficult if not impossible for a returning bank that is a second or third returning bank to know whether the paying bank started the return as a paper or electronic return, and thus whether notice to the BOFD would be required. More importantly, guaranteeing the BOFD a notice of all paper returns (whether the paper return was initiated by the paying bank or a returning bank) would eliminate any incentive for those BOFDs that are still only accepting paper return to migrate to electronic return.

Expeditious Return Test Should Not Be Reliant on Notices. It is the view of the Working Group that an ideal "end state" for the check industry is one in which there is no notice requirement on top of the return of the electronic check. That is, the speedy return of the electronic check will address any risk that the separate notice of nonpayment is intended to address under current Regulation CC. One benefit of this end state would be that the check industry would not have to maintain separate channels/operational support for notices and electronic returns. Certain Working Group participants, however, expressed the view that there may still be a need for Regulation CC 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 situation.

2. Comments to Alternative 2

General Comment Regarding Alternative 2. The Working Group views Alternative 2 as a more acceptable alternative compared to Alternative 1 because Alternative 2 encourages paying and returning banks to return items within the electronic channel in order to meet the expeditious return obligation imposed under Alternative 2. However, for the reasons discussed below, the Working Group does not support the adoption of Alternative 2 as currently drafted, and the Working Group has proposed an additional return test option for Alternative 2 as well as a notice of nonpayment for high dollar items.

Operational Difficulty with Paying Bank Implementation of Alternative 2. Participants in the Working Group expressed a concern that it would be operationally difficult and complex for a paying bank to know whether or not it had an electronic return arrangement to a particular BOFD in place via one of the paying bank's multiple returning banks. The status of an electronic return arrangement is particularly difficult for the paying bank to determine where it may take two or three returning banks to reach the BOFD. Working Group participants stated that in today's check processing environment, a returning bank does not inform its paying banks about which of the BOFD routing numbers available for return through the returning bank are in fact processed via a direct electronic return (that is, the connection is direct to the BOFD) or indirect electronic return (that is, connection to the BOFD via multiple returning banks). This operational complexity will make it difficult for a paying bank to determine its responsibilities to a particular BOFD for expeditious return and whether the paying bank has met its responsibilities by returning the item in a particular manner.

The Working Group discussed the potential that returning banks could make information regarding electronic return arrangements to BOFDs (both direct and through one or more returning banks) available to the paying banks with new routing tables. However, there was concern expressed that where multiple returning banks are needed to reach the BOFD, the returning banks would have difficulty keeping that routing table information current, and it would impose an additional burden on the paying bank to sort against those new routing tables.

Types of Electronic Returns under Alternative 2. With respect to what constitutes an electronic return arrangement under Alternative 2, the Working Group supports the addition of an appropriate Commentary within the final rule that states that an electronic return can include non-traditional electronic return arrangements agreed to by the participating banks, such as the electronic delivery to a BOFD of a PDF returns file. We believe this approach to return arrangements is consistent with the application of Regulation CC today and should be continued under the final rule.

Lack of Appropriate Incentives on Participants to Encourage Migration to Electronic Return. The Working Group is of the view that Alternative 2 may increase the incentive on a BOFD that already has in place at least one electronic return arrangement with a returning bank to expand

the BOFD's electronic return channels in order to ensure that the BOFD continues to receive the benefit of expeditious return under Alternative 2. BOFDs that are currently capable of processing electronic returns from certain returning banks will likely respond to the incentive under Alternative 2 to establish return arrangements with additional returning banks. However, the Working Group also is of the view that Alternative 2 does not create sufficient incentives to encourage those BOFDs that do not currently have any electronic return arrangements to sign up for electronic return. This is because the Working Group does not view Alternative 2 as increasing the risk sufficiently for those BOFDs that have only a relatively small number of returns.

Working Group participants also discussed, but did not reach a conclusion regarding, the question of whether Alternative 2 provides sufficient incentives on the paying bank to sign up with a returning bank that could reach a large number of BOFDs via electronic return. It was felt that paying banks may not take any additional steps under Alternative 2 to expand the number of BOFDs that the paying bank can reach with electronic return.

Unpredictability of Return Timeframes for BOFD. The Working Group is concerned that a BOFD that has multiple electronic return channels remains exposed under Alternative 2 to the risk of 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. For example, there could be a paying bank that isolates itself from the larger returning banks and only returns electronic checks through a smaller returning bank which does not have an agreement to send electronic returned checks to the BOFD or to another returning bank that has an agreement to send electronic returned checks to the BOFD. A second example would be where a paying bank uses only paper returns checks. In both of these examples, the paying bank would be exempt from any expeditious return requirement under Alternative 2. The Working Group is concerned that the BOFD will have no way of knowing that a particular paying bank is not connected to the BOFD's returning banks for electronic return. This risk of non-expeditious return, coupled with the removal of the notice of nonpayment for items over $2500, would place an inappropriate amount of financial risk on the BOFD that otherwise has made a reasonable effort to maintain sufficient electronic return channels that most paying banks can reach.

Possible Addition of Notice of Nonpayment to Alternative 2. Working Group participants are of the view that a notice of nonpayment requirement on the paying bank applicable to all paper return items would not improve Alternative 2. For the reasons discussed in our comments to Alternative 1, the addition of a notice of nonpayment for all paper return items to the BOFD would remove incentives on smaller BOFDs with relatively low overall number of returns to sign up for an electronic return channel.

The Working Group is of the view that if the Federal Reserve does determine to adopt Alternative 2 it would be appropriate to maintain a notice of nonpayment for high dollar items, returned either by paper or electronically, in order to protect BOFDs that have electronic return

arrangements in place, but are receiving a paper return from a paying bank that has chosen to have only limited electronic return channels. This notice of nonpayment should be set at a higher dollar threshold (such as $10,000, for example) than the notice established for returned items today under Regulation CC. The Federal Reserve may want to consider whether or not this notice of nonpayment should be subject to a phase-out in a fixed period, possibly 5-10 years, at which time it would be anticipated that the check industry would achieve 100 percent electronic return. (We have outlined this revised notice of nonpayment below.)

Addition of Forward Collection Test for Expeditious Return Under Alternative 2. As described above, the Working Group has identified a number of challenges with Alternative 2. A paying bank may face operational challenges to monitoring/determining the availability of an electronic return arrangement to a particular BOFD through the paying bank's available direct returning banks and the returning banks that are behind the direct returning banks. This monitoring obligation makes Alternative 2 of the Proposal potentially difficult to implement for paying banks and/or makes implementation more risky where a paying bank is uncertain whether it can reach a particular BOFD electronically for a return.

To address this risk, the Working Group recommends that the final rule include an additional test within Alternative 2 for a paying bank to meet its expeditious return obligation. In summary, this new modified forward collection test would provide that a paying bank may send an electronic return to a returning bank that is the same bank that the paying bank or a similarly situated paying bank, when acting as a BOFD, would use for the forward presentment of an item to the BOFD (if an item were drawn on the BOFD). In order to take advantage of this expeditious return test, the paying bank would have to send the return check to the returning bank as an electronic return, and not as a paper return. The returning bank would have a similar new test available to it, although the returning bank would have the option of sending a paper check to the BOFD, as it may not have an electronic return option available to the BOFD. (We have outlined this additional expeditious return option proposal in more detail below.)

This modified forward collection test will facilitate paying bank compliance when there is uncertainty regarding how the paying bank's returning banks can handle a particular return item. We have assumed for purposes of this additional test that Alternative 2, as set forth in the Proposal, is adopted in the final rule. However, the ability of the paying bank to use this forward collection test is not dependent on whether the paying bank could also satisfy the expeditious return test under Alternative 2. This is a separate stand-alone test for determining whether the paying bank has met its expeditious return obligation under Regulation CC.

This new expeditious return test is based upon the assumption that the BOFDs are best positioned and incented to take steps to ensure that they will receive expeditious return of all or most of their forward items. In this regard, we anticipate that when a BOFD implements the requirement, under Alternative 2 as proposed, that the BOFD maintain at least one connection for electronic return to a returning bank in order for the BOFD to be eligible for any expeditious

return of its items, the BOFD will sign-up for electronic return with either or both of (i) the collecting bank that already provides the BOFD with forward electronic image services, or (ii) a returning bank that has numerous connections to paying banks and other returning banks. Assuming one or both of these connections for electronic return are in place, when a paying bank utilizes this new forward collection test and sends the electronic return check to a returning bank that also handles forward exchange items to the BOFD, the return is likely to be processed electronically to the BOFD.

Outline of Revised Alternative 2 Including a Modified Forward Collection Test and a Modified Notice of Nonpayment. Below is an outline of the proposed changes that the Working Group recommends to Alternative 2.

A. Paying Bank Obligations

- Same expeditious return rule set forth in Alternative 2.

PLUS

- Paying Bank can also satisfy its expeditious return obligation by sending an electronic return to a bank (acting as a Returning Bank) that the Paying Bank or a similarly situated Paying Bank (acting as BOFD) would use to send a similar forward electronic item to the BOFD (acting as Paying Bank). The Paying Bank can send the electronic return to this Returning Bank regardless of whether or not the Returning Bank has otherwise agreed to handle the electronic return expeditiously to the BOFD under the 2-day expeditious return test as established by Alternative 2. This is a separate test, that is, to utilize this test, the Paying Bank is not required to have previously determined whether or not there is an electronic return option to the BOFD via one of the Paying Bank's direct or indirect Returning Banks.

PLUS

- Paying Bank is subject to notice of nonpayment for any high-dollar item (for example an item in excess of $10,000), provided that there is no obligation to send notice if the item will in fact be returned expeditiously to the BOFD within 2-day time period.

B. Returning Bank Obligations

- Same expeditious return rule set forth in Alternative 2.

PLUS

- Returning Bank can also satisfy its expeditious return obligation by sending an electronic or paper return (i) directly to the BOFD, or (ii) to a bank (acting as a Returning Bank) that the Returning Bank or a similarly situated Returning Bank (acting as collecting bank) would use to send a similar forward electronic item to the BOFD (acting as Paying Bank). This is a separate test, that is, to utilize this test, the Returning Bank can send the electronic or paper return to this second Returning Bank regardless of whether the second Returning Bank has otherwise agreed to handle the item expeditiously to the BOFD. The Returning Bank also is not required to have previously determined whether or not there is an electronic return option to the BOFD via one of the other Returning Banks to which the first Returning Bank has a connection.

Amendments To Proposed Alternative 2 To Implement Recommendation for New Forward Collection Test. Below is suggested regulatory text to implement the Working Group's recommendation for a new forward collection test as part of Alternative 2.

A. For Section 229.31 Paying bank's responsibility for return of checks and notices of nonpayment:

Add a new paragraph to the end of Proposed Alternative 2 Section 229.31(b) as follows:

"(3) A paying bank also returns a check in an expeditious manner if it sends an electronic returned check in a manner that it or a similarly situated bank would normally handle an electronic check—

(i) of similar amount as the electronic returned check; and
(ii) drawn on the depositary bank; and
(iii) deposited for forward-collection in the bank by noon on the banking day following the banking day on which the check was presented to the bank."

Add a new section to the end of the Proposed Alternative 2 for Commentary XVVII. Section 229.31.B Paying Bank's Responsibility for Return of Checks and Notices of Nonpayment as follows:

"3. Forward-collection test.

a. Under the forward-collection test, a paying bank returns a check expeditiously if it returns an electronic returned check in the manner that it or a similarly situated bank would normally handle an electronic check of similar amount as the electronic returned check that was drawn on the depositary bank. The paying bank can utilize this test regardless of whether the returning bank that it uses has agreed to handle the electronic returned check under the standards for expeditious return for returning banks under section 229.32. The paying bank also can utilize this test regardless of whether it has an agreement with the depositary bank or another returning bank that has agreed to handle

the electronic returned check under the standards for expeditious return for returning banks under section 229.32. This test allows paying banks a simple means of expeditious return of checks. By limiting this test to electronic returned checks (i.e., this test does not apply to paper check returns), it is anticipated that this test would not inordinately slow the return to the depositary bank. Moreover, for large dollar checks in excess of *[$10,000]*, the paying bank is required to provide notice of nonpayment to the depositary bank within the expeditious return deadline if the electronic returned check will not be received by the depositary bank by this deadline."

B. For Section 229.32 Returning bank's responsibility for return of checks:

Add a new paragraph to the end of Proposed Alternative 2 Section 229.32(b) as follows:

"(3) A returning bank also returns a check in an expeditious manner if it sends the returned check in a manner that it or a similarly situated bank would normally handle a check—

(iv) of similar amount as the returned check;
(v) drawn on the depositary bank; and
(vi) received for forward collection by the bank at the time the returning bank received the returned check, except that a returning bank may set a cutoff hour for the receipt of returned checks that is earlier than the cutoff hour of it or the similarly situated bank for checks received for forward collection, if the cutoff hour is not earlier than 2:00 pm."

Add a new section to the end of the Proposed Alternative 2 for Commentary XVVIII. Section 229.32.B Returning Bank's Responsibility for Return of Checks as follows:

"3. Forward-collection test.

a. The forward-collection test is similar to the forward-collection test for paying banks. Under the forward-collection test, a returning bank returns a check expeditiously if it returns the check in the manner that it or a similarly situated bank would normally handle a check of similar amount as the returned check that was drawn on the depositary bank. Unlike the forward-collection test for paying banks, the returning bank can satisfy the forward-collection test by sending an electronic returned check or paper returned check in accordance with the requirements of section 229.32(b)(3). If the returning bank determines to send the return to another returning bank rather than the depositary bank, the sending returning bank can utilize this test regardless of whether the receiving returning bank that it uses has agreed to handle the returned check under the standards for expeditious return for returning banks under section 229.32. The returning bank also can utilize this test regardless of whether it has an agreement with the depositary bank or

another returning bank that has agreed to handle an electronic returned check under the standards for expeditious return for returning banks under section 229.32. This test allows returning banks a simple means of expeditious return of checks.

3. Recommendation for the Phase Out of Paper Return

General Comment. The Working Group is of the view, and we believe that it is generally agreed within the check industry, that the industry should aim to achieve 100 percent electronic return in the very near future. Depositary institutions and the checking industry have achieved close to this goal, at 98 percent electronic return today, without a government mandate or the proposed regulatory incentives under one of the two Alternatives in the Proposal. Full 100 percent electronic return would speed the overall return of items, reduce financial risk to the check system, depositary institutions and their customers arising from slow paper return, and eliminate the cost of maintaining separate paper return channels in order to reach all BOFDs.

The Fed's current Proposal, including both Alternatives 1 and 2, attempts to provide regulatory incentives to encourage banks to migrate the last 2 percent of paper returns to electronic returns. However, based on review and discussions within the Working Group, it is not clear whether or not (i) the Proposal would in fact impose the right incentives on the proper parties, (ii) the Proposal would create unintended "gaming" consequences resulting in new inefficiencies within the paper or electronic check exchange system, and/or (iii) the incentives under the Proposal would be sufficiently strong to push the holdout BOFDs to accept electronic returns. For example, as discussed in our comments above, the Working Group is skeptical that a material number of the holdout BOFDs that are not on electronic return will face sufficient financial risk of late returns under either Alternative 1 or Alternative 2 to incent them to connect for electronic return. In a further example, there is concern among the Working Group that some smaller paying banks may drop out of electronic return today to avoid the obligations under Alternative 2 to determine the proper returning bank channel for electronic return to a BOFD.

There is substantial risk to the industry of the Federal Reserve adopting a final rule that contains incorrect or insufficient incentives to migrate the industry to 100 percent electronic return. First, there is the cost to each bank of implementation of a compliance program to meet the final rule requirements. Second there is the cost of operational changes necessary to implement the final rule. The industry would have to undertake such costs in the face of uncertainly as to whether the final rule would actually improve the current percentage of electronic returns. A mandated phase out of paper returns would remove the risk that a flawed regulatory incentive approach is locked into place by Regulation CC for many years and that the industry is delayed indefinitely in achieving full 100 percent electronic returns.

In light of the above, the Working Group recommends that the Federal Reserve establish under the final rule that all banks and depositary institutions will cease the use of paper returns within a designated time period. The Working Group believes that the appropriate transition period

would be two or three years from the date that the Federal Reserve issues the final rule establishing the requirements for the industry to migrate to full electronic return. It is anticipated that, during the interim period before complete phase out of paper returns, banks would develop sufficient electronic return connectivity and new return products and relationships to achieve 100 percent electronic return capability for all U.S. depositary banks. For items that are not eligible for electronic return due to a problem with the item itself, the final rule would allow the paying bank to return the item to the BOFD in the same manner and to the same location that the paying bank sends a collection item to the BOFD, or in the manner otherwise agreed to by the banks. It is anticipated that banks may develop an alternative electronic means of sending these ineligible return items, such as PDF files.

If BOFDs, returning banks and paying banks were required by Regulation CC to have full connectivity for electronic returns, the Working Group believes that the market would develop products and service options that would assist the banks in achieving full connectivity for electronic returns in the most efficient manner possible. For example, returning banks would be encouraged to cooperate with each other to establish greater connectivity between returning banks in order to ensure that each returning bank's paying bank respondents can achieve electronic returns for 100 percent of its items. At the bank and exchange level, there would be a strong incentive to work to improve or remove IQA screens and other issues that have in the past prevented certain items from being handled as electronic returns.

As part of this sunsetting of paper check returns, after the implementation date of the phase out of paper check returns, the Federal Reserve would maintain an expeditious return requirement under Regulation CC that would apply only to the electronic return process. We believe that Alternative 2, made applicable to only electronic returns, would be an appropriate expeditious return rule, with the changes to Alternative 2 that we are recommending above in Sections 229.31 and 229.32. To handle the transition to a full electronic return environment, we recommend that as of the effective date of the final rule, Alternative 2 would apply to both paper and electronic return checks, and that as of the implementation date of the phase-out of paper check returns, Alternative 2 would apply only to electronic return checks.

The Working Group recognizes that sunsetting paper returns is a substantial departure from the approach that the Federal Reserve has taken in the past with respect to the banks' migration from paper check exchange to image exchange. The Federal Reserve has primarily allowed market-based signals, and not government mandates, to set the timeframe for check industry's migration to electronic check exchange. The Working Group has supported this market driven approach in the past as the most efficient and fair method for achieving improvements to the check system, from the perspective of the participants and society at large. The checking industry participants have been cautious in the past and not recommended sunsetting of paper forward or return of checks.

However, the check exchange environment has undergone a fundamental change in the last ten years, and the check industry is now at a point were the most effective and reasonable means to improve and maintain the efficiency of the check system is for the Federal Reserve to directly sunset the paper return of checks. The other tools that the Federal Reserve is proposing, a mix of regulatory and operational incentives, are too blunt and too overbroad in application to achieve the narrow goal of moving the last 2 percent of paper return items to the electronic return channel. The Working Group believes that the challenge posed by the remaining 2 percent of the return items requires a narrow and directed approach. As a practical matter, the mandating of electronic returns will have no effect on the vast majority of return items, as they are already handled electronically. The sunsetting of paper return would establish a clear timeline, and remove the high degree of uncertainty as to the effectiveness of the two Alternatives in the Proposal in achieving a full electronic return environment.

The Working Group is not recommending that the Federal Reserve mandate in Regulation CC that financial institutions handle all forward presentment of items under electronic exchange arrangements. It is the experience of the Working Group that current operational advantages, collecting bank pricing, and other financial incentives are appropriately motivating BOFDs and paying banks to establish and maintain sufficient electronic check exchange arrangements to ensure that nearly 100 percent of the forward items are processed electronically from the BOFD to the paying bank. This is the case even when there are multiple collecting banks handling the electronic check in the forward exchange. The incentives that have supported this near 100 percent migration are the larger number of items in the forward collection exchange (compared to return items) and the resulting gains in collection cost savings and other efficiencies at both the BOFDs and the paying banks in handling electronic checks as opposed to paper checks. These incentives are not present or are not as substantial in the context of the return of items, as discussed above, and therefore this difference argues for the Federal Reserve's mandating of electronic processing in the context of returns and not in the context of forward presentment.

The Working Group is of the view that the Federal Reserve has the necessary authority under Section 609 of the Expedited Funds Availability Act to issue regulations to mandate this movement to an all-electronic return check system. Under Section 609(b) of the EFAA, the Federal Reserve is to consider requiring, by regulation, that "the Federal Reserve banks and depository institutions provide for check truncation," and "the Federal Reserve banks and depository institutions take such actions as are necessary to automate the process of returning unpaid checks." In addition, under Section 609(c), "in order to carry out the provisions of this title [the EFAA], the Board of Governors of the Federal Reserve System shall have the responsibility to regulate-- (A) any aspect of the payment system, including the receipt, payment, collection, or clearing of checks; and (B) any related function of the payment system with respect to checks." By mandating that depositary institutions use electronic return, the Federal Reserve would be taking an action that is now necessary to automate the return of checks that otherwise will be returned via an increasingly slow and costly manual paper return process, as banks take

down their paper check handling capability. As discussed above, a regulatory mandate of electronic return is a narrowly tailored solution to a problem, non-electronic return BOFDs, that the market and regulatory incentives have been unable to resolve.

Outline of the Regulatory Proposal to Sunset Paper Returns. Below is an outline of the regulatory changes to implement the Working Group's recommendation for the phase out of paper returns.

A. BOFD Obligations

- By the Implementation Date, BOFD would be required under Regulation CC to establish electronic return arrangements with one or more Returning Banks and Paying Banks such that BOFD will receive 100 percent of its return items via electronic return.

- For an item that is not eligible for electronic return (for example, low quality image), BOFD would be required to accept return of the item in a paper or electronic format in the same manner and location as the BOFD accepts collection items (in its capacity as a paying bank). Returned items sent in the manner of collection items would be limited ONLY to items that are ineligible for electronic return due to problem with the item itself. Banks also may agree among themselves how to handle the return of ineligible items. (Additional consideration will be needed regarding options for handling items that are not otherwise eligible for electronic return, for example banks may use PDF files to deliver ineligible items.)

B. Paying Bank Obligations

- As of the effective date of the final rule, Paying Bank would be required to comply with the Alternative 2 expeditious return rule (with changes recommended by the Working Group in Section 2 above) for both paper returns and electronic check returns. By the Implementation Date, Paying Bank would be subject to this expeditious return rule only for electronic check returns.

- By the Implementation Date, Paying Bank would be required under Regulation CC to establish electronic return arrangements with one or more Returning Banks and BOFDs such that Paying Bank can reach 100 percent of all BOFDs via electronic return.

- Paying Bank may return an item in the same manner and to the same location as Paying Bank sends collection items to BOFD (in its capacity as a paying bank) or a Returning Bank (in its capacity as a collecting bank) ONLY if the item is ineligible for electronic return due to problem with the item itself. Banks also may agree among themselves how to handle the return of ineligible items. (Additional consideration will be needed regarding options for handling items that are not otherwise eligible for electronic return.)

C. Returning Bank Obligations

- As of the effective date of the final rule, Returning Bank would be required to comply with the Alternative 2 expeditious return rule (with changes recommended by the Working Group in Section 2 above) for both paper returns and electronic check returns. By the Implementation Date, Returning Bank would be subject to this expeditious return rule only for electronic check returns.

- By the Implementation Date, Returning Bank would be required under Regulation CC to establish electronic return arrangements with one or more Returning Banks and BOFDs such that Returning Bank can reach 100 percent of all BOFDs via electronic return.

- Returning Bank may return an item in the same manner and to the same location as Returning Bank sends collection items to BOFD (in its capacity as a paying bank) or another Returning Bank (in its capacity as a collecting bank) ONLY if the item is ineligible for electronic return due to problem with the item itself. Banks also may agree among themselves how to handle the return of ineligible items. (Additional consideration will be needed regarding options for handling items that are not otherwise eligible for electronic return.)

Amendments To Regulatory Proposal to Sunset Paper Return. Unlike with the above recommendations to amend proposed Alternative 2, amendments to Regulation CC to sunset paper returns are not provided in this letter. We are assuming that the Federal Reserve will determine to request public comment on this recommendation if the Federal Reserve determines to pursue the sunsetting of paper returns. The Working Group will provide comments on proposed Regulation CC amendments to implement this recommendation in the context of that request for comment.

ATTACHMENT B

Matrix of Working Group Comments to the Federal Reserve Regulation CC Proposal

About this Matrix: This Matrix sets forth the Working Group's comments to certain of the proposed changes to Regulation CC, as set forth in the proposal published by the Federal Reserve Board on December 12, 2013 (the "Proposal"). Additional Working Group comments to the Proposal are included in the document at Attachment A. Individual members of the Working Group may submit separate comment letters taking different positions regarding one or more issues raised by the Proposed Rule.

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*§ 229.2(vv) – **Definition of Magnetic ink character recognition line and MICR line** – Commentary* Summary: Provides example that banks agreeing to exchange electronic checks may agree on applicable standards.	The Working Group supports the permissible variation of MICR line standards by agreement of the banks to the exchange. In addition, the Working Group supports the provisions throughout Regulation CC that permit the banks to vary the terms of Subparts C and D by bilateral agreement or through clearinghouse rule or other interbank agreement. This is critical to supporting technological and other check industry innovations and enabling competitive parity with Reserve Banks Operating Circulars. It also is consistent with check law generally (see e.g., UCC 4-103).
*§ 229.31(a) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Return of Checks – Rule*	NOTE: WORKING GROUP COMMENTS ON PROPOSED EXPEDITIOUS RETURN ALTERNATIVES ARE SET FORTH IN ATTACHMENT A.

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*§ 229.31(b) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Expeditious return of checks – Rule* Summary: For Alternative 1, removes all expeditious return requirements for paper and electronic checks. For Alternative 2, establishes 2-day expeditious return requirement for checks under Alternative 2. Changes receipt time for this requirement to 2:00 p.m. from 4:00 p.m. (in current rule) for Alternative 2. Removes the 4-day return and forward collection return test for both Alternatives.	Use of Multiple Returning Banks. *[Comment applies to both Alternative 1 and Alternative 2.]* The Working Group is of the view that if more than one returning bank is used to reach the BOFD in an electronic return process, it is possible, although increasingly unlikely, that the electronic return might not meet the 2-day expeditious return test. The speed of an electronic return when there is more than one returning bank will depend primarily on (i) the various cut-off times at the returning banks and the BOFD for processing/sending an electronic return, and (ii) the total number of returning banks in the process of a particular return. For example, there is relatively less risk that the electronic return would be received by the BOFD outside the 2-day expeditious return test when there are two intermediary returning banks, as compared to three intermediary returning banks. The Working Group is of the view that the use of more than two returning banks is relatively uncommon and should decrease in frequency as more electronic return connections are developed between returning banks. In addition, it is the experience of a number of banks participating in the Working Group that act as returning banks that many returning banks can send the electronic return to either the BOFD or another returning bank during the same banking day that they receive the electronic return from the paying bank. That is, many returning banks do not have to wait until the bank's overnight processing cycle to move the electronic return to the BOFD or the next returning bank. This same day processing of returns reduces the risk in the context of multiple returning banks that the BOFD would receive the return outside the 2-day expeditious return test.

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*§ 229.31(d) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Notice of nonpayment – Rule* Summary: For Alternative 1, establishes a requirement to send notice of nonpayment if paying bank returns paper check. Changes content requirement and timing requirements for notice.	*[Notice of nonpayment comments apply to Alternative 1 as proposed. Comments would also apply to Working Group's suggested revision to Alternative 2 to add a notice of nonpayment.]* Reliance on Delivery Schedules For Notice of Nonpayment. The Working Group does not support the proposed requirement that the BOFD actually receive the notice of nonpayment by 2:00pm (local time) the 2nd day after presentment. The paying bank generally relies on a third party service provider to assist it with the delivery of notices of nonpayment to the BOFDs, and the paying bank is not in control of the manner in which and the time by which a particular notice is delivered to a BOFD for a particular check return. As such, the Working Group is of the view that it is appropriate to allow the paying bank to rely on the service availability schedules issued by the third party notice providers that establish when the notice of nonpayment will generally be received by the BOFD. In addition, since there is no expeditious return requirement under Alternative 1 for electronic return of the check itself, the Working Group believes that it is similarly not appropriate to require that the notice of nonpayment actually be received by the BOFD by a fixed time. Operational Cost/Burden of Changing Time of Receipt for Notice of Nonpayment. The Working Group does not see a material operational cost or burden of moving the deadline for receipt by the BOFD of the notice of nonpayment to 2pm (local time) the 2nd day after presentment from the current 4pm (local time) the 2nd day after presentment. In addition, the Working Group is of the view that an earlier notice, in the context of Alternative 1, would be beneficial to BOFDs generally. This support for the earlier deadline for the notice of nonpayment is based on the assumption that the service providers that provide the banks with notification services are given sufficient time to make any necessary changes to their service to support the earlier delivery time, and that paying banks are permitted to rely on the availability schedules of the notice service providers in determining whether or not the paying bank has satisfied its notice of nonpayment requirement. (Reasons for reliance on

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	availability schedules for notice of nonpayment are discussed in prior comment above). Proposal's Inclusion of MICR Line Information in the Notice. The Working Group supports the Proposal's inclusion of the MICR line information as a data element in the notice of nonpayment. We are of the view that this data element in the notice will assist BOFDs in the handling of the notice of nonpayment. Account Number of Depositor Customer in Notice of Nonpayment. The Working Group is of the view that the notice of nonpayment should not include the account number of the depositing customer, even if that information is available to the paying bank. The BOFD will not need, and likely would not use it even if it were provided in the notice of nonpayment, the account number information of the depositing customer. The BOFD will rely on the information in its own deposit/check processing system to determine to which account the item is to be charged back. In addition, the Working Group is of the view that it is better for privacy and data security reasons to remove this account number from the notice of nonpayment. We recommend that the Federal Reserve Board not require this data element in the notice of nonpayment requirement. Branch Name/Number in Notice of Nonpayment. The Working Group is of the view that the "branch name or number of the depositary bank from its indorsement" is not a useful element of information for the notice of nonpayment. A BOFD would not use the branch name or number in the notice of nonpayment for any internal processing or investigation. Rather, the BOFD would rely solely on the information that is in the BOFD's check processing or deposit account system for determining the internal source of the check deposit and the appropriate location for posting of the return. We recommend that the Federal Reserve Board remove this data element from the notice of nonpayment. Paying Bank Name In Notice of Nonpayment. The Working Group is of the view that the data element

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	"name of the paying bank" is not a useful element of information for the notice of nonpayment. The BOFD should rely on the identity of the paying bank that is associated with the MICR line routing number information, and not on the name of the paying bank in the notice of nonpayment. We recommend that the Federal Reserve Board remove this data element from the notice of nonpayment requirement. Notice of Uncertainty As to Accuracy of Information. The Working Group recommends that the Federal Reserve Board remove the Section 229.31(d)(2)(ii) requirement that the paying bank indicate in the notice of nonpayment those data elements about which the paying bank is uncertain as to their accuracy. It is the experience of the Working Group that this type of statement within a notice of nonpayment is very infrequently used, and that paying banks typically do not have a means of knowing which information is uncertain as to accuracy. In addition, there is no standardized code or symbol that is agreed upon within the check industry for a bank to indicate uncertainty with respect to data in a notice of nonpayment or any other electronic check record. The asterisk (*) is used within check industry standards to refer to data that could not be read or interpreted as MICR characters. However, this asterisk symbol would not be appropriate for other uncertainty situations that could arise in the data fields of a notice of nonpayment. Exception to Notice of Nonpayment For Unidentifiable Depositary Bank. The Working Group strongly supports the exception from the notice of nonpayment in the event that the BOFD is not identifiable. In addition, the Working Group does not support the addition of any new obligations on the paying bank under Regulation CC in the event that the BOFD is unidentifiable. It is the experience of the Working Group that the inability of a paying bank to identify the BOFD is generally caused by (i) a failure of the BOFD to place its indorsement on the paper item before imaging, (ii) a failure of the BOFD (or its agents) to include all the BOFD's electronic indorsement record information in the check image data files, or (iii) the failure of a collecting bank to preserve or include all BOFD electronic

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	indorsement record information in the check image exchange file. These causes of an unidentifiable BOFD for an item are not under the control of the paying bank, and the BOFDs are in the best position to address these causes. Furthermore, as a practical or operational matter, there is little more beyond what is already required in Regulation CC that the paying bank could do to identify or route the return or notice of nonpayment when the BOFD is unidentifiable.
*§ 229.31(e) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Identification of returned check – Rule* Summary: Provides banks with flexibility on location of placement of return reason. Changes "face of check" to "front of check".	Return Reason Location. The Working Group supports the proposed revisions to Section 229.31(e) that would require that 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 is in conformance with how the check industry is handling placement of return reasons today under the X9.100-140 standard, and this proposed change would conform Regulation CC to current operational procedures.
*§ 229.31(e) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Identification of returned checks – Commentary* Summary: Provides examples of placement of return reason.	Use of "Refer to Maker" as a Return Reason. The Working Group supports the decision by the Federal Reserve Board not to completely ban the use of the "refer to maker" return reason. In addition, the Working Group believes that return reasons should be addressed in the context of check industry standard and operational practices, not within Regulation CC. While we believe that the overall use of the "refer to maker" return reason has declined in recent years due to new available alternative return reasons and changes to paying bank practices, the Working Group is of the view that the check industry still needs the "refer to maker" return reason option. The current alternative return reasons available within the check industry technical standards for electronic

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Limits use of "Refer to Maker" return reason.	check return do not address all of the situations and reasons that a paying bank may have for returning an item. For example, the Working Group believes that paying banks need the "refer to maker" return reason in a situation where they have suspicion of possible fraud of the check or the account, but the paying bank has insufficient information to form a conclusive view. In such a situation, particularly taking into account potential liability considerations, "refer to maker" is the more appropriate return reason, as opposed to a return reason code which references fraud. In addition, there may be situations where the paying bank does not have sufficient time to determine the true nature of return reason where there appears to be conflicting reasons, such as possible duplication or possible counterfeit or altered items. Paying banks have very limited time to review the facts involving a particular return, and use of the refer to maker reason may be appropriate where the paying bank cannot make a determination within its midnight deadline of a more specific return reason between two conflicting return reaons. The Working Group agrees that as a general matter, the "refer to maker" return reason should not be used in a situation involving a duplicate presentment. However, for the reasons discussed above, we recommend that in the final rule the Commentary discussing permissible return reasons provide examples to paying banks on when it may or may not be appropriate to use the "refer to maker" return reason in the context of a suspected duplicate presentment, but that the Commentary not establish a strict prohibition on the use of "refer to maker" for suspected duplicate presentments. Furthermore, for the same reasons, we do not support any additional restrictions or prohibitions in Regulation CC on a paying bank's use of the "refer to maker" return reason. <u>Consideration of Elimination of Regulation CC Commentary Regarding the "Refer to Maker" Return Reason</u>. We recommend that the Federal Reserve Board consider removing all reference to the "refer to maker" return reason in the Commentary to Regulation CC. It is unusual that Regulation CC only addresses the appropriateness of one of the multiple return reasons that are available to a paying bank. In addition, the presence of the Commentary setting forth when a particular return reason may be used

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	by a paying bank may expose the paying bank to liability under Regulation CC if the paying bank fails to use the "refer to make" return reason in accordance with the Regulation. We recommend that Regulation CC reference the check industry standards for the list of permissible return reasons and that the Federal Reserve work within the industry standards group to provide guidance to the check industry on use of return reasons for particular types of returns.
*§ 229.31(f) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Notice in Lieu of Return – Rule* For Alternative 1, deleted requirement of expeditious delivery requirement for notice in lieu of return. For Alternative 2, incorporated in the notice content requirements that were already in place for the existing notice of nonpayment.	Content of the Notice in Lieu of Return. *[Comment applies to both Alternative 1 and Alternative 2.]* Please see our comments above regarding the content of the notice of nonpayment. We have the same comments here regarding the content of the notice in lieu of return.
*§ 229.31(f) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Notice in Lieu*	When Item is Unavailable For Return. The Working Group supports the proposed new Commentary that would clarify that an item is unavailable for return if the paying bank does not have a sufficient image of the front and back of the check, or an image is not in the correct format, in order to create a

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of Return – Commentary Provides new examples of when notice in lieu may be used in context of electronic return. Deems original item unavailable if image cannot be used to create a substitute check.	substitute check. We agree with this approach to defining an item unavailable for return. In the case of an insufficient image in the paying bank archive, the check image would not be eligible under applicable exchange rules for electronic return to the BOFD. In addition, because of the insufficient image, the paying bank could not create a substitute check from the image in its archive in order to send the return to the BOFD via a substitute check. As such, the item is unavailable for return and it is appropriate to use a notice in lieu of return. Like other sections of subpart C, this approach to unavailable items should be variable by the banks exchanging the item by agreement or clearinghouse rules under Section 229.27.
§ 229.31(g) – ***Paying bank's responsibility for return of checks and notices of nonpayment.*** *– Extension of deadline – Commentary* Provides examples of extension of deadline in context of electronic returned checks.	Timing of Receipt of Items For purposes of the UCC Midnight Deadline. We support the addition of the new proposed Commentary #3 that provides an example of when an item is received by the BOFD. We agree that the timing of receipt of an electronic return check by the BOFD is appropriately determined by the agreement of the BOFD and the paying bank, as the example in the Commentary provides. This agreement could include bilateral agreements and clearinghouse rules or operating circular, and we recommend the Federal Reserve Board revise the Commentary to reference these examples of agreements. We also found the proposed Commentary discussion of the timing of receipt at the BOFD in the context of the UCC midnight deadline potentially confusing. The placement of the commentary regarding the receipt of the item at the BOFD could suggest that receipt of the item is somehow relevant for determining compliance with the UCC midnight deadline. We recommend that the Federal Reserve Board revise this Commentary to more clearly indicate that the paying bank satisfies its return obligation under the UCC in the context of an electronic return check when the paying bank sends the electronic return check from the paying bank's location in accordance with the UCC midnight

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	deadline.
*§ 229.31(i) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Reliance on routing number – Rule*	Routing of "Not Our Items" in Return Process. The Proposal requested comment on whether Regulation CC should prohibit a returning bank, which handled a particular item in the forward collection process, from rejecting a return item back to the paying bank or another returning bank on the basis that the item is a "not our item" or "NOI". The Working Group does not support the inclusion of such a prohibition in Regulation CC. While the Working Group acknowledges that there are problems with banks misusing NOI in the return process, the Working Group believes that a rule governing the routing of returns in this situation should be handled by the banks under clearinghouse rules, operating circular or bilateral agreement. The Working Group believes that there are exceptions and variations to the use of NOIs in the return process that should be dealt with in more detail in clearinghouse rules, operating circular or bilateral agreement. This approach would provide a more nuanced and appropriate treatment of NOIs as compared to a complete ban under Regulation CC.
*§ 229.31(i) – **Paying bank's responsibility for return of checks and notices of nonpayment.** – Reliance on routing number – Commentary* Summary: Allows paying bank to rely on data regarding BOFD that is in electronic check information.	Reliance on Routing Number in Electronic Information. The Working Group agrees with the addition of a new example in the proposed Commentary that allows a paying bank to rely on the electronic routing number of the BOFD that is included "in the electronic check sent pursuant to an agreement". This approach will conform Regulation CC to industry practice which is to rely on the electronic indorsement record that accompanies the electronic check when determining the appropriate BOFD for routing of the return.

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*§ 229.34(a) – **Warranties and indemnities.**– Warranties with respect to electronic checks and electronic returned checks– Rule* Summary: Establishes new warranties for forward presentment and return of electronic checks and electronic returned checks. Warranty extends to other banks and to drawer/owner of check.	Content of the Electronic Check Warranties. The Working Group supports the content of the proposed electronic check warranties. These warranties are consistent with the approach to electronic check warranties as prescribed in Regulation J, ECCHO Operating Rules and the bilateral agreements of which the Working Group is aware. Variation of the Electronic Check Warranties. The Working Group supports the approach in the Proposal that permits banks to vary the application of the new electronic check/check return warranties, both with respect to the banks participating in the check image exchange presentment and with respect to banks' depositing customers and drawer customers. The ability to vary the warranties will allow banks the flexibility to support the processing of check images that may not always conform to industry standards for check exchange or that may not contain a complete image of the original paper check. These non-conforming or incomplete items may still be appropriate for electronic image exchange under certain circumstances and with appropriate protections and agreements of the exchanging parties. For example, given the decline in the availability of delivery routes for paper check exchange, banks participating in a particular exchange relationship may determine that it is more efficient and customer-friendly to exchange items by image even if there is only an incomplete image. In these situations, the exchanging banks may want to alter the application of the electronic check warranties to encourage the exchange and settlement of these items. The ability to vary the application of the electronic check/check return warranties by agreement also will facilitate electronic check collection/return experimentation and innovation. The Working Group requests that the Federal Reserve Board add additional commentary to Section 229.37 to provide a non-exclusive example of permissible variation of these warranties. Scope of the Application of the Electronic Check Warranties. Under the Proposal, the electronic check warranties made by an exchanging or returning bank would extend to the drawer customer (on the

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	forward side) and the depositing customer (on the return side). The Working Group is concerned that this approach to the electronic check/check return warranties will give a bank customer the ability to make breach of warranty claims against banks that are not otherwise in direct contractual privity with the customer. As the Federal Reserve Board is aware, the interbank warranties in place today for electronic check exchange in Regulation J and the ECCHO Rules do not extend to the customers of BOFDs or paying banks. It is the view of the Working Group that the relationship of the customer and the bank should be governed by applicable law and the account agreement between the customer and the bank, and that the customer should pursue any claims the customer has with respect to a particular item directly against the customer's account holding bank. If the customer's claim relates to or arises from an act or omission of another bank in the forward or return process, the account holding bank would pay its customer and then pursue the other bank on the claim. We see a few potential concerns with the Proposal's approach to having banks (other than the account holding bank) make warranties to drawer customers and depositing customers with respect to the electronic check or electronic return check. First, allowing customers to bring actions based on a breach of warranty against banks in the check collection process other than their account holding bank could complicate the appropriate resolution of the dispute. The account holding bank is almost always going to be a necessary party to any check dispute brought by its customer, as the account holding bank will either have information relevant to the dispute or it may have been itself a source of the breach of the warranty claim. Second, only the account holding bank is in a position to vary the warranties with respect to its customers under the account agreement and to limit the liability of the bank to the customer. For example, the account holding bank may impose an obligation on its customer to review the account statements and paid items within a certain period of time and notify the bank of any potential errors or claims. Other banks in the check collection process will not have the same means of limiting their liability to the account holding bank's customer. This ability to limit liability to a

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	customer is particularly a concern with large dollar business checks where banks typically "cut down" the time period within which the business customer must review an item, and typically offer products such as image positive pay that allow business customers to review items quickly and notify the bank of possible errors. If Regulation CC enabled customers of the account holding bank to bring claims directly against other banks in the check collection system, these limitations on liability would be undermined and banks would have significant exposure. The Working Group recommends that the Federal Reserve Board consider the following approach to address the issue of the extension of warranties to customers. For customer beneficiaries of the warranties, Regulation CC could limit the application of these electronic check/check return warranties to apply only between the account holding bank and its customer (that is, for the BOFD, the depositing customer and for the paying bank, the drawer). This approach has the benefit of providing a drawer/depositing customer with a warranty claim for electronic checks/check returns on a uniform basis, but does not complicate the inter-bank warranty process or expose banks other than the account holding bank to potential direct liability to account holding bank's customers.
*§ 229.34(b) – **Warranties and indemnities.** – Indemnity with respect to an electronic image or electronic information not related to a paper check* Summary: Provides indemnity for the losses that arise from receipt of electronically created item.	General Comment Regarding the ECI Indemnity Provision. The Working Group supports the approach in the Proposal to provide protection to the paying bank in the event that the exchange of ECIs causes a loss to the paying bank that would not have arisen had an electronic check, created from a paper check, been exchanged between the banks. We believe that this indemnity approach to protection of the paying bank in Regulation CC reasonably addresses the risk of ECIs. In addition, this approach enables innovation by providing flexibility for banks to exchange electronic payment orders ("EPOs")s or other types of ECIs among themselves, and to vary the indemnity as needed under Section 229.37, as necessary to support their program.

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	The Working Group would not support any approach to ECIs in the final rule that directly or indirectly prohibited banks from exchanging ECIs in the future. While there is not today an ECI check product that is widely offered, the Working Group is aware that there are efforts underway within the banking industry and within corporate payers and payees to consider the possibility that a form of an ECI product could be developed to bring efficiencies to certain types of check payments, such as business to business payments. For this reason, we believe that Regulation CC in general, and this indemnification for ECIs within the Proposal in particular, should not prohibit the potential for additional innovation in this area of check payments. Indemnity Versus Warranty for ECIs. The Working Group generally supports the indemnity approach to protect paying banks and other receiving banks from damage or loss that may arise from the receipt of an ECI. There is concern in the Working Group that the use of the indemnity approach, as opposed to a warranty approach, would in some manner require a higher degree of proof of loss causation by the paying/receiving bank when making an indemnity claim to the sending bank. As the Federal Reserve Board is aware, many of the liability provisions in the context of check collection are in the form of warranties provided by the sending bank and breach of warranty claims brought by the receiving bank. We suggest that the Federal Reserve Board revise this section to establish a combination warranty and indemnification approach for ECIs, that is similar to the approach in Sections 229.52 and 229.53 of Regulation CC for the substitute check warranty and indemnification. That is, the final rule should establish that the sending bank warrants to the receiving bank that the electronic check exchanged was created from an original paper check, and there would be a related indemnification provision by the sending bank for all losses associated with the breach of the warranty. For the reasons discussed above, it is critical that this warranty and related indemnification can be varied by agreement, such as through clearinghouse rule, Operating Circular or bilateral agreement. Coverage of RCC ECIs. We recommend that the Commentary to Section 229.34(b) include an

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	example of how an ECI that is also a remotely created check (RCC) (that is, the ECI does not purport to bear the signature of the account holder of the paying bank) would be covered under this new warranty/indemnity for ECIs. There has been some uncertainty and discussion in various check industry forums regarding how an RCC, which is also an ECI, would be covered under the warranty in Regulation CC that protects the paying bank from losses associated with unauthorized RCCs. For example, the final rule could include new Commentary that stated: "In the event that a paying bank receives an electronic image that is an ECI and the ECI does not purport to bear the signature of the paying bank's customer, the paying bank would be entitled to indemnification under this provision in Section 229.34(b) for all losses that arise to the paying bank from the receipt of the ECI in the same manner as if the presenting bank had breached the RCC warranty in Section 229.34(b) of Regulation CC." Damages for Losses Associated with Regulation E Non-Compliance. The Working Group would support changes in the final rule or the related Commentary that clarified that a paying bank may bring a claim under the new ECI warranty/indemnity to recover the paying bank's losses arising from Regulation E non-compliance which were caused by the receipt of the ECI, as opposed to an electronic check (created from the paper original check). Because the paying bank does not control the creation of the ECI and may not be able to identify that an ECI was presented to it for posting, in the event that the paying bank incurs loss arising from Regulation E noncompliance, the paying bank should be able to recover such loss from the BOFD or other sending bank. The Working Group does not in this letter take a formal position on whether ECIs are currently subject to Regulation E or should be made subject to Regulation E by an amendment to Regulation E. Application of the ECI Indemnity To Unauthorized Items. We request that the Federal Reserve Board provide a more detailed commentary regarding the application of the indemnity to an ECI that is an

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	unauthorized item. The proposed commentary to this section in the Proposal states that the indemnification claim would be available to the paying bank if there was an ECI for which the customer disputes authorization, but the paying bank has no means to prove authorization because the paying bank could not examine a source paper check. We request clarification in the final rule as to whether or not this commentary means, as a practical matter, that in any dispute by the customer regarding authorization of an ECI, the paying bank always has a claim under the indemnity to a prior transferring bank. This could be because the paying bank would not have a customer signature on the ECI to examine to help the paying bank prove authorization, since the ECI was created electronically and not from a paper signed by the customer. We request that the Federal Reserve Board provide additional examples of the application of the indemnity in the situations involving unauthorized items. Extension of ECI Indemnity or Warranty to Drawer Customers. The Working Group agrees with the approach in the Proposal that the indemnification relating to ECIs should not extend to the drawer customer. In the event that the Federal Reserve Board adopts the Working Group's recommendation that the final rule include a warranty for the exchange of ECIs, we also would not support the extension of that new ECI warranty to the drawer customer. In the context of ECIs, the drawer customer is already protected from losses associated with an ECI under applicable law and the account agreement that the drawer has with the paying bank. Specifically, absent a change in the UCC, an ECI may not qualify as a "negotiable instrument" or an "item" under Articles 3 and 4 of the UCC, and therefore, absent the agreement of the customer in the account agreement, the ECI will not be properly payable by the paying bank. As the ECI is not properly payable by the paying bank, the drawer customer would have a claim against the paying bank under the UCC and/or the account agreement in the event the drawer customer incurs a loss associated with the ECI. Finally, for the reasons set forth above in the context of the discussion of the scope of the Electronic Check and Electronic Return Check warranties, extending Regulation CC warranties or indemnities to bank customers will complicate the

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	resolution of interbank claims. Comparative Negligence Defense To ECI Indemnity Claims. The Working Group does not agree with the proposed approach in Section 229.38(c) of the Proposal to allow a sending bank to raise a comparative negligence defense to the indemnification claim by the paying bank in the context of the exchange of ECIs. We feel that a comparative negligence standard is not appropriate in the context of exchanges of ECIs. The availability of a comparative negligence standard for ECI indemnification claims will complicate the resolution of these claims by paying banks, as BOFDs or other sending banks will raise a comparative negligence defense in order to improve their bargaining position in the context of adjustments and other claim processes between the banks. The Working Group believes that, absent agreement of the banks to exchange ECIs, the losses associated with ECIs should be placed solely on the bank that allowed the ECI to enter into the check payment system. The paying bank had no control over the creation of the ECI or its entry into the check processing system, and therefore the BOFD or other sending bank should not be able to raise a comparative negligence defense. This is the case even if the paying bank's negligence may have contributed to some degree to the losses arising from the processing and posting of the ECI. Regulation CC has allowed for comparative negligence for warranties under Regulation CC. By comparison, other check exchange warranties under check law, such as the transfer warranties under Section 4-208 of the UCC, are not subject to a comparative negligence defense. In the context of the ECI indemnity, we believe this UCC approach is the correct one.
*§ 229.34(g) – **Warranties and indemnities.** – Truncating bank indemnity – Rule*	General Comment in Support of the Truncating Bank Indemnity. The Working Group supports the Federal Reserve Board's initiative in proposing a new indemnity between the truncating BOFD and the second BOFD that accepts the original paper check for deposit. With the growth in consumer remote

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Summary: Establishes new indemnity between truncating bank and other BOFD(s) which accept the original paper check for deposit after image deposit at truncating bank.	deposit capture over the last few years, the Working Group members have seen an increase in duplication of presentment of electronic checks occurring in the context of remote deposit capture. The check industry has been working to address this increase in duplication through a number of different efforts including, (i) education of banks regarding their responsibilities and obligations under law and check image exchange rules for items deposited by their customers, (ii) changes to the interbank adjustment rules to facilitate the adjustment of these duplication claims, and (iii) discussions of possible "best practices" for banks handling duplication claims where one BOFD (or its customer) still has the original paper item. It is the experience of the Working Group that at this time there is no single warranty, indemnity or best practice that can facilitate the proper adjustment of all duplicate items, as the fact patterns in which the duplication arises vary. With that background, the Working Group is of the view that the Proposal's truncating bank indemnification is a step forward in the right direction. 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 after the image deposit. While this proposed truncating bank indemnity does not address the full range of RDC duplication scenarios, this indemnity does address a scenario where 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. <u>Requirement to Charge the Depositing Customer's Account</u>. The Proposal does not address whether or not the second BOFD is required to attempt to charge its depositing customer's account for the return item before the second BOFD would have the right to make an indemnity claim against the truncating bank. We believe that, as a policy matter, the loss for duplication claims when the second BOFD has the original paper check should be allocated to the truncating bank (and possibly the truncating bank's customer). It will delay the full resolution of the duplication claim if the second BOFD were required to attempt to charge the item back to its depositing customer. We recommend that the final rule

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	clarify that the second BOFD can make the indemnity claim to the truncating bank without first seeking to charge the item to the BOFD's depositing customer's account. Comparative Negligence Defense to Indemnification Claims. For the reasons set forth in the Working Group's comments to the ECI indemnity, we do not believe that a comparative negligence approach is appropriate for duplication warranty claims. We believe that such a rule will not assist the two BOFDs in the speedy resolution of these claims, but will rather create greater uncertainty and delay in the processing of these indemnity claims. Time Period for Making Indemnification Claim or Notice of Claim to Truncating BOFD. The Working Group recommends that the final rule include a time period within which the indemnified BOFD (referred to herein as the "second BOFD") must make a claim under the indemnity to the truncating BOFD. The Working Group recommends that this time period be structured in a manner similar to the time period for a notice of a claim under current Section 229.56(d). Under Section 229.56(d) a person making a claim under the Subpart D Check 21 warranty or indemnity must provide notice of the claim to the warranting or indemnifying bank within 30 calendar days of the date that the person knows of both the claim and the identity of the warranting or indemnifying bank. The Working Group is of the view that a time period for making the claim or providing notice of the claim is important for this new truncating bank indemnity because quick notice of the claim may assist the truncating bank in obtaining funds from its depositing customer that caused or participated in the duplication. Truncating Bank Indemnity Not Applicable to Counterfeit or Altered Items. The Working Group anticipates that there will be questions and challenges when the check industry seeks to implement this novel truncating bank indemnity within the existing inter-bank adjustment framework. Accordingly, the Working Group recommends that the final rule include examples of when the truncating bank

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	indemnity is not applicable to a particular factual situation. We believe that these examples will assist banks in having a uniform understanding of the scope of the new indemnity. For example, we recommend that the Commentary to the final rule state that a claim under the truncating bank indemnity is not available when the second BOFD incurs a loss on a check deposit that is the result of an alteration of an item or a counterfeit item that is not the same item that was deposited by image at the truncating bank. It is the experience of the banks today that not infrequently a claim of duplicate presentment can actually involve an altered item or a counterfeit item. We believe that these situations are more appropriately handled under the existing rules for altered or counterfeit items, rather than this new truncating bank indemnity. Limitation on Availability of Indemnification By Truncation Bank. The Working Group is concerned that the existence of the truncating bank indemnification may encourage behavior by certain persons that will increase unnecessarily the overall risk to check system participants in certain duplication scenarios. We are concerned that the existence of the indemnity will encourage check cashers, and other persons that obtain checks as transferee from the payee, to not exercise appropriate due care when cashing checks. For example, we are concerned that check cashers may disregard facts and data at the time of cashing of the item that would suggest that an item has been previously deposited with another bank by means of image deposit. These suggestive data could include crossed out or missing indorsements or items that are dated weeks from the current date but that are not yet stale. As a result of the new indemnity, the check casher will know that the check casher's BOFD is more protected against risk of loss from a duplicate deposit, and therefore there is a decrease in the likelihood that BOFD will impose the loss on the check casher. Without the indemnity protection via its BOFD, a check casher in the normal course may have a holder in due course claim against the drawer of the check in the event of a return, since the check casher may obtain the paper item from the BOFD in the return. However, these

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	HIDC claims are more expensive and time-consuming to pursue, and therefore may encourage due care in accepting checks, compared to a potential indemnity claim to the truncating BOFD by the check casher's BOFD. We request that the Federal Reserve Board consider imposing in the final rule a limitation on when the truncating bank indemnity is available to the second BOFD and indirectly its customer. At a minimum, the new indemnity should not be available if the second BOFD or its customer (such as the check casher) is not a holder in due course with respect to the item or the item is missing indorsements. In addition, the indemnity should not be available to the second BOFD if the person that deposited the check at the BOFD is the same person or legal entity as the person that deposited the item to the truncating bank or otherwise benefited from the deposit of the item to the truncating BOFD. Finally, the indemnity should not be available if there is evidence on the item itself that suggests that the item may have been deposited previously with another bank by means of an image deposit, such as crossed-out payee indorsements. In these situations, the loss for a duplication of an item is appropriately allocated to the second BOFD and its depositing customer, as they are best positioned to control losses in these types of duplicate deposits. Process For Making Indemnity Claims. This indemnification provision between two BOFDs is a novel approach in check law, and possibly in other payment system law as well. We are not aware of any similar formal rule under the other payment systems. We are aware that banks use an informal indemnification letter to request the return of funds between two account holding banks in the event of certain errors or misdirected funds, but such situations are informal and not meant to address the same type of situations raised by the truncating bank indemnity. Because it is a novel indemnity, there will be some operational issues with implementation, including for example a process for the second BOFD to obtain information from the paying bank to identify the other BOFD where the item was truncated and a process for the inter-BOFD indemnity claim. In addition, financial institutions, exchange

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	networks and clearinghouses may want to establish standard required representations or factual predicates that the second BOFD must satisfy when making an indemnity claim to the truncating bank, such as a representation that it had no knowledge of the prior image deposit when it took the paper deposit from its customer. The Working Group expects that the Reserve Banks and the private sector adjustment providers will need to develop adjustment services to support the second BOFD in identifying the truncating BOFD and otherwise pursuing the indemnification claim. We request that the Federal Reserve Board consider including additional Commentary to the final rule that supports the establishment by banks and other check system participants of these types of processes to help BOFDs make and settle indemnification claims. Returns and Adjustment Claims. The text of the truncating bank indemnity in the Proposal, as well as the Commentary to the proposed rule, state that the indemnity is available to a BOFD if the BOFD receives a "return" of the electronic check or paper check after presentment of the item to the paying bank. We recommend that the rule and the commentary be revised to state that the indemnity also is available when the BOFD receives a duplicate presentment warranty or other claim from the paying bank (or another bank in the check exchange process), such as a warranty claim through the interbank adjustment process. In many cases involving duplicate presentment the paying bank does not return the second presented item to the second BOFD. Rather, the paying bank will make a warranty claim of duplicate presentment by means of an adjustment claim. It is our view that the truncating bank indemnity should be available to the second BOFD in this situation.
*§ 229.35 – **Indorsements**– Rule* Summary: Deletes reference to Appendix D and replaces with industry standards	Deletion of Appendix D. The Working Group recommends that the Federal Reserve Board maintain a version of Appendix D in Regulation CC in order to clearly establish as a matter of regulation the responsibilities of banks with respect to indorsements. There have been growing problems in the check industry with BOFDs not complying with the requirements in Appendix D for the BOFD indorsement

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references.	and otherwise cluttering the back of the check image. This non-compliance by the BOFDs is complicating and delaying the processing of returns to BOFDs. The Working Group is concerned that if Regulation CC defaults to check industry standards for the bank indorsement requirements, there will be increasing problems with BOFD non-compliance.
*§ 229.36(b) – **Presentment and issuance of checks**– Receipt of paper checks– Rule* Summary: Permits paying bank to require separation of forward and return paper items.	Separation of Presented Items and Returned Items. The Working Group supports the change to Section 229.36(b)(2) to allow a paying bank to require that items that are presented to the paying bank be separated from return items that are being returned to the paying bank (as a BOFD). The Working Group also supports maintaining the current approach in Section 229.32(a) of Regulation CC that allows a BOFD to require that returned items be separated from items that are being presented to the BOFD (as a paying bank).
*§ 229.36(f) – **Presentment and issuance of checks**– Same-day settlement– Rule* Summary: Retains current SDS rule. Applies to paper presentment only.	General Comment. The Working Group spent a significant amount of time considering the same day settlement (SDS) issues raised by the Proposal, including whether or not the Working Group would take a position (i) in support of the phase out of the paper SDS rule, and/or (ii) in support of the establishment of a new electronic SDS option within Regulation CC to take the place of the paper SDS rule. Our below comments reflect that there is a diversity of views on these issues within the Working Group. The Working Group reached a consensus position that it would like to see the eventual elimination of the paper SDS rule to reflect that the checking industry has migrated to electronic clearing of checks, and therefore banks should not have to maintain capability for paper check presentment and receipt. There also was concern that a presenting bank would misuse the paper SDS rule to insist on paper

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	presentment and settlement, even when there was a reasonable electronic presentment option available to the presenting bank via one or more correspondent banks. For the reasons discussed further below, the Working Group is of the view that the paper SDS rule should be eliminated when the Federal Reserve Board has either implemented an electronic SDS rule or developed an alternative policy or rule that addresses the competitive concerns that the paper SDS rule was intended to address. The Working Group did not reach a consensus position regarding the need for the establishment of a new electronic SDS option within Regulation CC to take the place of the paper SDS rule. This lack of a consensus position in the Working Group with respect to this question reflects a difference in opinion among the banks in the Working Group regarding the merits of the electronic SDS rule, even if it was technologically feasible. One group of banks within the Working Group sees operational and efficiency merit in having only one, or a limited number of, electronic exchange arrangements, and this first group of banks is concerned that an electronic SDS rule would require a bank to manage multiple electronic exchange arrangements. This first group of banks in the Working Group does not support an electronic SDS rule. In a contrasting position, a second group of banks in the Working Group expressed a view that, even though the industry is in a fully electronic check exchange environment, the fundamental policy reasons behind the paper check SDS rule have not gone away. The paper SDS rule was adopted by the Federal Reserve Board in order to address certain competitive advantages that the Reserve Banks have compared to the private sector correspondent banks when presenting and settling checks to paying banks. Specifically, the Reserve Banks can present items to any paying bank without paying a presentment fee and the Reserve Banks can obtain same day settlement for the presented items from the paying bank's account at the Federal Reserve. Furthermore, many paying banks, preferring to have single or a limited number of presentment points, would impose fees or settlement delays on presenting banks to force or encourage the presenting banks to use the paying bank's preferred presentment

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	channel (either the Reserve Bank or another private sector correspondent bank). The existing paper check SDS Rule addressed both of these related competitive challenges in the pre-SDS paper check environment by allowing presenting banks to directly present under the SDS rule without fee and with same day financial settlement. This paper SDS rule in time encouraged paying banks to enter into clearinghouses and other direct exchange arrangements in order to avoid paper SDS presentments, and thus encouraged a robust range of clearing options for paper check exchange. This second group of banks is of the view that the migration to a fully electronic exchange environment has effectively destroyed the competitive equalization value of the paper SDS rule to private sector correspondent banks and their exchanges with paying banks. Without an SDS rule type option in the electronic exchange environment, the competitive concerns that were identified in the pre-SDS rule environment are returning to check image exchange. Moreover, there are additional factors in the electronic check exchange environment, which were not present when the paper SDS rules were developed, that increase the concern regarding the Reserve Banks' competitive advantage in electronic presentment. These factors are (i) the relative cost and complexity for paying banks, particularly smaller banks, to maintain multiple electronic channels for presentment, compared to multiple paper check presentment options; and (ii) current Reserve Bank pricing that charges a fee on a paying bank for delivery of electronic items, providing a revenue option for Reserve Banks where private sector collecting banks lack the competitive position to impose such a fee on the paying bank. According to this second group of banks, a presenting bank or a collecting bank should not be forced by the high cost, high risk (of slow forward delivery) or practical impossibility of paper delivery to go through a Reserve Bank's (or any collecting bank's) exclusive electronic presentment channel to a particular paying bank in order to obtain payment of the check from a paying bank. Accordingly, this second group of banks sees two alternatives. First, the Federal Reserve Board could develop an SDS rule for the electronic exchange environment. This approach would have to address

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	the operational and implementation issues that are set forth below. As an alternative to a new SDS rule, the Federal Reserve Board could develop a new regulatory and policy approach either within Regulation CC or otherwise, not reliant on the traditional concepts of the paper SDS rule, to address the Reserve Bank's competitive advantage in electronic presentment. The second group of banks is of the view that the failure of the Federal Reserve to take prompt steps to address this current competitive imbalance may result in migration of a substantial portion of electronic exchange volume to the Reserve Banks, and a reduction in the competitive environments for check exchange. It is not unexpected that there is a lack of consensus within the Working Group regarding the need for an electronic SDS rule and/or how electronic SDS rule could be implemented. There was a strong difference and range of opinions within the check industry regarding the paper SDS rule. This difference in opinion regarding the paper SDS rule and now the possibility of an electronic SDS rule reflects in part the different interests and views of correspondent banks, large check deposit receiving banks and smaller paying banks. Accordingly, the Federal Reserve should not view this lack of consensus within the Working Group as an endorsement or acceptance of the Federal Reserve taking no action on the fundamental competitive concerns that underlie the original need for the paper SDS rule and the need for a successor rule or policy to the paper SDS rule for the electronic exchange environment. Rather, the second group of banks within the Working Group is of the view that this lack of consensus reflects that the continued existence of fundamental competitive and policy questions regarding check presentment should be addressed more directly by the Federal Reserve in a different regulatory or policy forum that includes a range of potential solutions to the competitive issues, not just an electronic SDS rule solution. <u>Issues with Possible Electronic SDS Rule</u>. As indicated in the above comment, there are a number of challenges to an electronic SDS rule. The primary obstacle is that all electronic exchange arrangements are predicated on the agreement of the two banks which details a number of

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	technological and operational elements that are necessary for electronic check presentment to function, such as location of the electronic check image file delivery, technical standards for the electronic check image file delivery, data security, interbank rules governing the exchange, and other similar issues. These operational and technical issues are not present in paper check exchange, where the paper instruments can be delivered to a designated presentment point with no other operational agreement or technical implementation requirements. The Working Group considered, but did not reach a consensus on, possible approaches to address these implementation challenges, including: (i) requiring the presenting bank to pay for some or all of the upfront costs of the establishment of the electronic check presentment arrangement; (ii) requiring the paying bank to designate an electronic presentment point at one or more of the paying bank's forward correspondent banks where any presenting bank could deliver electronic checks in the same format/rules etc. that otherwise govern other exchanges through that correspondent bank; or (iii) allowing the paying bank to limit the total number of separate electronic connections for presentment of electronic checks or impose limits on the number/type of electronic checks per file of presented electronic checks.
*§ 229.37 – **Variation by Agreement***	Response to Federal Reserve Questions Regarding Timing of Presentment of Check Image/Data. The Federal Reserve Board expressly asked for comment on whether or not the final rule should prohibit variation by agreement relating to certain practices of paying banks relating to early receipt of electronic information regarding check images to be delivered at a later time. It is the understanding of the Working Group that in the check industry today a paying bank receives the check image file and the associated electronic data file at the same time. This is the case for check exchanges through the larger check image networks as well as those bilateral agreements which participants commented upon. While we have not conducted a formal survey of Working Group participant financial institutions, based on comments received during our review of these Federal Reserve questions, we are not aware of

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	paying banks that share interest or other compensation associated with check collection practices. In any event, the Working Group is of the view that Regulation CC should not prohibit or otherwise limit the ability of banks to vary by agreement, including through bilateral agreements and clearinghouse rules, the provisions of Subpart C, except for the existing provisions of Section 229.37 prohibiting disclaimer of a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or the limiting of the measure of damages for such lack or failure.
*§ 229.38(d) – **Liability**– Responsibility of certain aspects of checks– Commentary* Summary: Incorporates text from current commentary paragraphs 12-14 of §229.35(a) regarding liability of parties for back of check.	Use of Carbon Bands. The Working Group is of the view that there is little or minimal usage of carbon bands on the back of checks, and this text could be deleted from the Commentary.
*§ 229.38(g) – **Liability**– Jurisdiction*	Date of the Occurrence of the Violation. Under Section 229.38(g), any action under subpart C shall be brought within one year after the date of the occurrence of the violation involved. We suggest that the Federal Reserve provide new commentary to Section 229.38(g) that provides an example of how the one year time period in Section 229.38(g) will apply in the context of the new electronic check duplication warranty and the new truncating bank indemnity. The occurrence of the violation of the new duplication warranty or truncating bank indemnity could be separated in time from the exchange of the item that gave rise to the warranty or indemnity. The final rule could provide commentary that states that the occurrence of the violation in the context

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	of the no duplicate payment warranty is the date of the second presentment and the date that the warranty by first BOFD is breached. For example, assume BOFD A presents an electronic check to the paying bank, and therefore makes the warranty of no subsequent duplicate presentment of the same item. BOFD B receives the deposit of the same item paper form two months later, and presents the item to the paying bank. The date of presentment of the item by BOFD B is the date of the occurrence of the violation with respect to BOFD A's warranty to the paying bank. The date that BOFD A presented the electronic check is not the relevant date for tracking the one year period under Section 229.38(g). Similarly, for purposes of the truncating bank indemnity, the occurrence of the violation would be the date that BOFD B receives the return of the item from the paying bank and incurs a loss due to that return of the item.
*§ 229.39(c) – **Insolvency of Bank**– Preferred claim against presenting bank for breach of warranty– Rule* Summary: Retains "preferred claim" for breach of warranty.	Maintain the Preferred Claim. The Working Group supports maintaining in the final rule the preferred claim against the presenting bank in the event of a breach of warranty. Participants in the Working Group indicated that this preference provision was considered and relied upon in various instances during the recent financial crisis. This approach to warranty claims is appropriate as it reflects the fact that financial institutions view many warranty claims on a check as a continuation of the original check payment, and not as a separate legal claim. For example, under check adjustment rules for many types of warranty claims, the two banks will settle the claim with financial entry. For certain warranty claims, there are limited reasons that the presenting bank can refuse the warranty claim or reject financial settlement for it. Because financial institutions treat warranty claims as part of the original check payment that was previously settled to the presenting bank before receivership, the paying bank should have a preference for the warranty claim in receivership above other claims of the failed presenting bank.

MATRIX OF COMMENTS TO REGULATION CC PROPOSAL

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*§ 229.52(a) – **Substitute check warranties**– Content and provision of substitute –check warranties. – Rule* Summary: Establishes that warranty applies to substitute check returned in connection with a deposit reject.	Rejection of Deposit. The Working Group supports the amendment to Section 229.52(a) to provide that a depositary bank that rejects a check deposit and returns a substitute check to the customer makes the warranties under Section 229.52(a)(1), regardless of whether the depositary bank receives consideration in connection with the item. This revision to the regulation provides an important clarification on the application of the Check 21 Act/Regulation CC warranty and related indemnity for substitute checks. This clarification permits the depositary 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. The Working Group supports all of the proposed revisions to the regulation and commentary in Sections 229.52 and 229.53 to implement this clarification on the application of the Check 21/Regulation CC warranty and indemnity for substitute checks.
*Additional Issue for Comment: **Effective Date***	Effective Date. The Working Group supports a delayed effective date for the final rule of at least six (6) months from the publication of the final rule.
*Additional Issue for Comment: **Definition of RCC***	Definition of Remotely Created Check. The Working Group requests that the Federal Reserve Board revise the definition of "remotely created check" in the final rule to provide greater clarity regarding the type of items that come within the definition and therefore are subject to the warranty as to customer authorization. Specifically, we recommend that the Federal Reserve Board define a "remotely created check" as an item that does not contain the signature of the drawer and was created by the payee or the agent or service provider of the payee. This definition will bring within it the types of items that are generally the source of consumer disputes regarding authorization. In contrast, the revised definition of remotely created check should exclude an item that does not contain the drawer's

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	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. 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. The current definition also inappropriately includes 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 the payee. It is the experience of the Working Group that there are frequent cases where 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. In both these cases, 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. This requested change in the definition of RCC will make the paying bank responsible for the payment and determination of authorization of those items that are created by the account holding customer and the agent and service providers of the account holding customer. This is an appropriate allocation of liability as the paying bank, and not the BOFD or the payee, is best positioned to monitor its customer's authorization of these types of items. In addition, frequently these types of customer-initiated items are created in the context of the paying bank's own online bill payment service where the account holding customer is making a payment through a bill payment service. The paying bank is best positioned to control authorization for unsigned drafts created in the context of its own bill payment service, regardless of whether the service is offered directly by the paying bank or by a third

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	party service provider to the paying bank. Items Issued By Drawer Without Signature. Under the 2006 final rule amending Regulation CC to include the new warranty for remotely created checks, the Federal Reserve Board adopting release stated that the definition of "remotely created check" included an item that the customer issued but neglected to sign. However, there is no similar statement in either the rule text or the Commentary to Section 229.34(d) or Section 229.2(fff). Our above proposed revision to the definition of the "remotely created check" is intended to exclude from the definition of RCC those items that a drawer customer issues and neglects to sign. The paying bank and its customer are best positioned to protect themselves from the issuance of an unsigned item by the customer, and this loss should not be placed on the BOFD and indirectly its depositing customer. A large utility customer and its BOFD, for example, that accept millions of checks a year via lockbox do not have the ability to review all deposited items for the presence of a customer signature, and the utility customer and its BOFD should not bear the risk of loss where the drawer customer caused the item to be issued without a signature. In the case of a missing signature, the paying bank can determine from the item itself that the paying bank should not pay the item. That is, the item will have a missing drawer signature and the item will not otherwise contain any other indication, such as a legend of "Customer Authorization On File" that would suggest that the item was created by the payee. We also believe that the paying bank generally will be able to determine whether a check was created by its own customer or the payee, such as by the form of the check, the check sequence number or other information on the check, or information it obtains from its customer. For the reasons set forth above, the Working Group recommends that the Federal Reserve Board add new commentary or change the rule definition of RCC to exclude those items that are issued by the drawer customer without a signature.

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Additional Issue for Comment: ***Presumption of alteration.***	Presumption of Alteration. The Working Group supports 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. The Working Group believes that there is a value to having a predictable and uniform national rule for the resolution of this type of dispute. A uniform rule is of particular value since there are different court decisions governing how this type of dispute is resolved under the law. The Working Group supports a rule within Regulation CC that creates a presumption of alteration, and not of a counterfeit item. As the Federal Reserve Board noted in the Proposal, the ECCHO Rules establish a presumption of alteration in the context of exchanges that are governed by the ECCHO Rules. This ECCHO Rule was adopted after consideration of the options for the evidentiary presumption, and the ECCHO Rule reflects the view of the ECCHO members that in a situation where there is a lack of evidence, it is more likely than not that the item is in fact an altered item. For example, in the context of a corporate client with a positive pay service in place, a counterfeit item is not likely to be paid since the dollar amounts will not match, whereas an altered item will be paid when the dollar amounts and check number match, but the proceeds are taken by an altered fraudulent payee. We have conducted an informal survey of financial institutions participating in the Working Group and have not been able to determine the extent to which the current presumption of alteration under the ECCHO Rules has been used to resolve disputes between banks. However, this lack of usage information may reflect that banks have multiple groups handling check claims and may not have centralized and detailed records of the ultimate resolution of all check disputes.

MATRIX OF COMMENTS TO REGULATION CC PROPOSAL

Section of Proposed Rule and Summary of Change	Working Group Comments
General Comment – ***References to Industry Standards.***	References to Industry Standards. There are a number of references in the Proposal to the industry standards that govern the creation and indorsement of paper checks, electronic checks and substitute checks. There have been recent changes to the names and/or numbers of these industry standards, and the final rule should revise the names and/or numbers of the standards to refer to the current names and/or numbers, as set forth below: • ANSI X9.100-160-1-2009, Magnetic Ink Printing (MICR) Part 1: Placement and Location • ANSI X9.100-187–2013, Electronic Exchange of Check and Image Data • ANSI X9.100-140–2013, Image Replacement Document – IRD • ANSI X9.100-111-2009, Physical Check Endorsements