MICHIGAN CREDIT UNION LEAGUE & AFFILIATES

May 2, 2014

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

RE: Comments on Docket No. R-1409 and RIN No. 7100 AD 68, Availability of Funds and Collection of Checks, Regulation CC

VIA ELECTRONIC MAIL: www.regulations.gov

Dear Mr. deV. Frierson,

The Michigan Credit Union League (MCUL), the statewide trade association representing 98% of the credit unions located in Michigan and their 4.55 million members, appreciates the opportunity to comment on the Federal Reserve Board's (FRB's) proposed revisions to Regulation CC.

Remote Deposit Capture (RDC)

The FRB's revisions to Regulation CC propose to indemnify a depositary bank for losses when that bank accepts a deposit of an original check where a check has already been paid by another depositary via remote deposit capture (RDC). Under the proposal, the depositary institution that accepted the original check would be allowed to directly recover from an institution that permitted its customer to deposit through RDC. The FRB indicates in the proposed rule that the depositary institution that benefits by permitting its customers to use RDC should also internalize the risk or cost to other institutions that may result from RDC. According to the FRB, the institution that accepted the check via RDC is in a better position than any other to minimize those costs and risks through the terms of its contract with the customer. The MCUL strongly disagrees with the FRB's rationale and proposed indemnity requirements.

While most of the proposed revisions to Regulation CC encourage the electronic processing of checks, the shift of liability for RDC would do the opposite, providing a strong disincentive for the use of electronic deposits via RDC. Credit unions currently offering RDC believe the risk of liability would materially impact their RDC programs, increasing costs and limiting services. This proposal penalizes the use of improving technology and providing high quality, desirable services to credit union members.

Currently, the industry operates on a "first in, wins" basis. A credit union that receives a returned check for fraudulent purposes is responsible to take appropriate action against the consumer that negotiated the check. This does not generally present a problem, as the institution should have a member or customer relationship, and therefore has the necessary

information on file to attempt to collect from that individual. To the extent that loss occurs, the risk would be more appropriately placed on the institution that did not do its due diligence documenting the customer's information for purposes of recourse, rather than an unsuspecting, unrelated depositary that is managing an otherwise appropriate RDC program. While the FRB indicates in the proposed rule that the depositary institution that benefits by permitting its customers to use RDC should also internalize the risk or cost to other institutions that may result from RDC, the MCUL views this as a step backwards. Over the last decade, enhancements to regulations have been made to provide for an electronic check processing landscape, including amendments in this proposal. RDC is a critical component of that electronic check processing framework and the potential for fraud does not justify the liability shift the FRB is proposing. This type of unqualified liability shift will have a significant chilling effect on a desirable service for consumers that is prevalent and continues to grow exponentially.

Related to the previous issue, the MCUL concurs with the FRB's concerns that a depositary that accepts an original check would have a difficult time identifying a depositary that accepted and received settlement for a deposit made through a RDC service. Therefore, the idea that the depositary that accepts the original check for deposit may be indemnified by another depositary that permitted its customer to deposit the check through RDC is convoluted at best, and not a realistic option to implement. The second institution negotiating the paper check will need to know who the first RDC institution was. The only financial institution that would have that information is the institution that the check is drawn on. Is the FRB prepared to work with other agencies to provide clear authority for the sharing of this type of information? Further, determinations by the paying institution of whether the original deposit was conducted via RDC will require investigatory resources. This proposal presents practical as well as privacy concerns, in addition to arbitrarily assigning risk of loss to an unrelated institution.

Credit unions offering RDC do everything they can to limit the potential for fraud. Before credit unions make the determination to offer RDC, a specific risk analysis is performed and relevant parameters are established in order to mitigate those identified risks. For example, credit unions often place strict limitations on daily and monthly deposits. Additionally, contracts can provide for the revocation of RDC privileges for customers that misuse the service. It is also common to have risk mitigation tools mechanically built in to the RDC program, including restrictive indorsement features and requirements (e.g., "for mobile deposit only" designations, etc.). The FRB may wish to consider, in the alternative, structuring requirements for these types of tools, and keying liability from failure to comply with such.

For the reasons described above, the MCUL does not believe the proposed liability associated with RDC is properly placed. The FRB's proposal will chill the expansion of RDC as an offered service, which runs contrary to the system of electronic check payment and return system that the amendments on the whole are driving toward.

Return Requirements

Alternative 1: The first alternative presented in FRB's proposed amendments on return requirements attempts to incentivize depositary institutions to accept electronic returns by eliminating the expeditious-return requirement. Those depositary banks that do not currently accept electronic returns would have a greater incentive to do so, because only by receiving returns electronically would those institutions learn about nonpayment of a deposited check within the current expeditious-return timeframes. This alternative also imposes a notice-of-nonpayment requirement on paying banks that choose to send a paper return, regardless of the amount. According to the FRB, this is intended to provide paying banks with an incentive to return checks electronically in order to avoid the costs and burdens associated with providing the notice of nonpayment.

Alternative 2: Under the second alternative for return requirements, paying and returning banks would have an expeditious-return requirement only if the depositary bank has agreed to accept electronically returned checks directly from the paying bank or from another returning bank with which the paying bank has an electronic return agreement. It also eliminates the notice-of-nonpayment requirement for all returned checks. According to the FRB, those depositary banks that do not currently receive electronic returns would have a greater incentive to do so because they would not otherwise be entitled to expeditious return of unpaid checks and would therefore be at a greater risk of having to make funds available to their customers before learning the checks were unpaid.

The MCUL is generally supportive of Alternative 2 and understands that FRB wishes to encourage institutions to move to an electronic return process. However, the FRB should be cognizant of the amount of infrastructure needed and training that will be needed for such a transition. Small credit unions that are still filing returning paper would need a significant amount of time to transition to an electronic process. If adopted, the MCUL requests that the FRB provide an implementation timeframe of at least one year.

Electronically-Created Items

Electronically-created items are electronically created images that resemble the fronts and backs of paper checks, but are not created from, e.g., scanning a paper check to create an electronic image. FRB should clarify the indemnities and warranties in Regulation CC that should apply to electronically-created items. However, as electronically-created items are fairly recent developments and FRB should provide appropriate flexibility for financial institutions to vary certain terms by agreement, and also address risk management regarding the unique properties and risks associated with electronically-created items.

Delayed Effective Date

FRB should delay the effective date of any final rule by at least one year from issuance, to provide an appropriate amount of time for implementation. The proposed changes regarding paper returns will disproportionately impact those small institutions that currently rely on the medium. Institutions offering RDC will need time to make risk management decisions and implement appropriate changes to their programs, including any compliance needs, disclosures and agreements, training, etc. As the FRB is aware, all financial institutions face

significant compliance burdens and challenges in the current regulatory environment. Allowing institutions an appropriate amount of time to assess and adapt to substantive and technical changes to Regulation CC will result in an orderly transition that will benefit institutions, and ultimately the consumers that use these programs.

Summary

The proposed revisions to Regulation CC raise significant concerns for the necessary technological growth and advancement within the industry that consumers expect, and increasingly demand. Portions of this proposal would negatively impact credit unions' desire and ability to offer RDC services for their members, given the unpredictable and arbitrary risk of having to indemnify an unknown and speculative number of institutions in the event of manual fraud, no matter what precautions they may have taken. Those that do make the risk-based decision to continue the service will be forced to decide upon increased fees to mitigate risk and keep the product viable. RDC usage has more than doubled among credit unions over the past year – this service is increasingly necessary to accommodate members' needs and to keep pace with other industry actors. The MCUL strongly encourages the FRB to reconsider the shift of liability as proposed.

With regard to return requirements, while the MCUL supports the proposed "Alternative 2," it is not without concern for the impact on smaller credit unions that currently use paper returns. At a minimum, a timeframe for compliance of at least a year would be appropriate and highly beneficial for those institutions already struggling with an unprecedented amount of new regulation from many agency sources.

The MCUL appreciates the opportunity to provide comments to the FRB on this proposal, on behalf of its membership.

Sincerely,

Ken Ross
Executive Vice President & Chief Operating Officer