



Member FDIC

March 8, 2004

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

RE: Proposed Rules, Regulation CC, Docket No. R-1176, Availability of Funds and Collection of Checks, Check 21

Sent via e-mail to - regs.comments@federalreserve.gov

Dear Ms. Johnson:

I am writing in regards to the above referenced docket and proposal concerning **Availability of Funds and Collection of Checks**. This proposal was published in the Federal Register on January 8, 2004, Volume 69, No. 5, on Pages 1470 through 1501. Comments are due **March 12, 2004**. Check 21 goes into effect October 28, 2004.

National Penn Bancshares, Inc. ("National Penn") is currently a \$3.5 billion financial services company headquartered in Boyertown, Pennsylvania. National Penn currently operates 66 community offices in southeastern Pennsylvania, with over 900 employees, through National Penn Bank and its FirstService and HomeTowne Heritage Bank divisions. Trust and investment management services are provided through Investors Trust Company and FirstService Capital; brokerage services are provided through Penn Securities, Inc.; mortgage banking activities are provided through Penn 1st Financial Services, Inc.; insurance services are provided through FirstService Insurance Agency; and equipment leasing services are provided through National Penn Leasing Company

Listed below are our comments regarding the above referenced proposed regulations:

Timing and the Customer Impact

Ideally, changes such as this should allow for a 12 month implementation period, in order to adequately change processes, procedures, disclosures, customer relations, and provide consumer and employee training. I base my comments on my direct experience as project manager in implementing the recent USA Patriot Act and CIP (Customer Identification Program) throughout our organization.

Check 21 is a fundamental, large-scale change that intimately touches customer's paper checks. Customers value their paper checks, not because they are paper, but because they are warehouses of crucial payment information. Understanding and communicating the benefits of Check 21, from the customer's perspective substantially increases our customer relations obligations. Changes of this magnitude require a serious allocation of time and resources designed to train and educate customers, and employees alike. A mass mailing and a perfunctory employee training session may, however be all that banks can allot if given a short implementation time of 3 to 6 months. Customers are the backbone of our industry and we feel the communication needs to be more than just cursory. (Comments based on the final rules being published in May or June 2004, with an effective date of October 28, 2004.)

Fraud is not going away.....it will evolve.

Check 21 may dramatically shrink the check clearing time line, allowing a further reduction of frauds such as account takeover and identity theft. However, two potential areas that have yet to be explored, and for which the additional guidance may be warranted are:

Authorized Transactions

The use of faceless transactions and increased use of electronic checks may cause a need for financial institutions to review its policies and determine the extent to which there is a need to verify that an individual is authorized to transact business on a particular account. Since banks may at time no longer have a paper check to inspect, it is likely that counterfeiters will exploit the inability of digital images and substitute checks to retain traditional security features such as water marks, as well as capture certain types of forgeries and alterations.

Timeframes to hold deposits on accounts

The time frames that banks are allowed to hold deposits may be reduced making fraud more difficult to prevent under Regulation CC. By reducing the consumer's time for availability, it may force the bank to have potential fraudulent collections after they have already made the funds availability.

Managing Image Quality

While major strides have been made in check imaging technologies in recent years, we have yet to deal with a world in which digital images are the primary settlement instrument and legal record for check transactions. It is likely that early experiences with image quality will be a key factor in determining how aggressively the industry adopts image exchange. The regulation is silent on the standards regarding image exchange. Some important issues include:

Is the image readable?

Is it the correct image?

Has the image been tampered with? Is the transaction fraudulent? How can you be sure?

Does the payment information on the image match the payment information sent with the image?

When an image file is received, does it in fact contain an image?

Under the regulation, a bank has set time periods to investigate claims. The paying bank's ability to respond to the consumer in any time frame is obviously dependent on the cooperation of the bank that created the substitute check. We feel the guarantee goes a long way towards placing accountability where it belongs; however, without any standards for image exchange, that guarantee may mean different things to different institutions. The result may not always benefit the customer.

Retention Requirements

The Check 21 Act is silent on addressing how long we have to keep the original paper documents. Is it 0 days, 2 days, 3 days, 30 days, 61 days, or some other requirement? The regulation leaves it completely up to the financial institution to determine any retention policies on the storage of checks that have been converted to images. Obviously, a \$10 check may not have the same motivation for retention that a \$1 Million check would.

I feel this is an important question since the bank that creates the image must guarantee that the digital file is adequate for settlement, since it can be held liable if the image is unreadable. Leaving retention to "whatever the bank wants to do", opens banks up for consumer criticism, particularly on larger checks and those payments that have far-reaching effects. For example, a check might be written for a small amount, but it could be somebody's homeowners, or auto insurance premium. If the house burns down, or the automobile is destroyed, and the policy doesn't cover it, because the premium was never paid, the bank could potentially be responsible.

The Proposal listed specific requests for comments throughout the Section by Section Analysis, these are listed below:

Board Specific Question: (Federal Register page 1475, top left corner) The Board requests comments on what benefits, if any, there would be in providing returning banks with the flexibility to indorse on the front of checks and to include additional information in their indorsements.

It is our belief that indorsements should be restricted to the back of the check, where clear space would not restrict or hinder the ability to read such indorsement. Additionally, placing indorsements on the front of the check may hinder the ability to detect whether any fraudulent alterations were made to the instrument, should the need arise. We are not opposed to anyone adding additional information to their indorsements, provided it is relevant, meaningful and does not obliterate reading of pertinent information.

Board Specific Question: (Federal Register, page 1476, middle center column) The Board specifically requests comment on whether using information from a check to create an ACH debit entry should be a payment request by this warranty.

This question really boils down to whether an ACH Debit should be allowed to replace a check, which falls under Check 21. This is perhaps one of the most difficult for our customers to understand. Many times, the customer goes to a merchant, purchases something with a check, and finds out the merchant substituted the check with an ACH debit, in order to obtain faster availability of their funds. The consumer's perception is that this was often done underhandedly, without the consumer's knowledge, particularly when they don't receive their cancelled check in their account statement. It is our belief that the substitution of an ACH Debit for a check should only be allowable with the customer's consent.

Board Specific Question: (Federal Register, page 1478, top right corner column) The Board requests comment on whether or not its proposed reorganization of the statutory provisions regarding action on claims is an improvement over the statutory organization and encourages commenters to provide specific organizational suggestions.

We believe the proposal as written and reorganized is satisfactory, and have no additional suggestions.

Board Specific Question: (Federal Register, page 1478 – 1479, bottom right, top left) The proposed rule would allow the bank to reverse both the amount it previously recredited plus any interest it has paid on that amount. The statute does not explicitly address the reversal of interest when reversing a

recredit, and the Board specifically requests comment on whether the proposed approach is appropriate.

We believe allowing for the reversal of the recredit, as well as the interest is the correct procedure, as described in the proposal.

Board Specific Question: (Federal Register, page 1479, top left corner)

The proposed commentary to §229.54(C) clarifies that a bank that receives claims for multiple substitute checks in the same communication must provide the expedited recredit for each such check by the 10th day after submission, unless the bank by that date has determined whether or not the claims are valid. The Board requests comment on whether additional commentary to §229.54 would be useful and, if so, what specific points should be covered.

It is our opinion that this proposed commentary is clear. While we understand the consumer's need to have funds recredited, 10 days may not be sufficient time to fully research complicated claims. In those isolated cases where we would have to reverse the recredit because it was not valid, it may cause some customer issues such as confusion, a possible overdraft, etc. that may require additional customer explanations.

Board Specific Question: (Federal Register, page 1480, bottom right column)

The Board has proposed two alternative rule provisions regarding when a bank must provide the disclosure to a consumer who requests a copy of a check. One alternative tracks the statute and requires a bank to provide the disclosure at the time of the request, but the other alternative requires provision of the disclosure at the time the bank provides the substitute check to the consumer. The Board specifically requests comment on which of these alternatives is preferable.

We believe the disclosure should be given at the time of the request for a copy of the check.

In Addition the Proposal Listed Specific Requests for Comments A through D as listed below (page 1482):

A. Treatment of Generally Applicable Industry Standards

We agree specific industry standards should be included in the commentary only to make it easy to revise. The text of the rule should state that industry standards might be updated from time to time in the commentary.

B. Relation of the Check 21 Act to Other Law

We believe the descriptions are adequate; however as issues develop, additional commentary may be warranted.

C. Remotely-Created Demand Drafts

It would be appropriate to incorporate the UCC revisions into Regulation CC. However, care should be used in drafting this section to avoid confusion with checks turned into ACH Debits.

D. Use of Plain Language

It is always difficult to make regulatory legalese plain language, because of the interpretive meanings placed by individuals with varying backgrounds. I believe the language as presented to be adequate.

In conclusion, I do feel that Check 21 is a once-in-the-century opportunity, where the rewards can be enormous, for the bank and the consumer. For financial institutions adopting imaging, it can reduce the paper handling, transportation costs, check processing and clearing expenses, as well as reducing float. For the consumer, they will benefit by overall efficiency of the nation's payment systems.

In this letter, I have outlined some areas where I feel clarification or specific guidance may be warranted. I appreciate your consideration of my comments. Should anyone have questions concerning the comments, I may be reached during business hours at (610) 369-6185.

Sincerely,

Debra A. Wetzel, MBA, CIA, CRCM, CRP
Vice President and Compliance Officer

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