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Via E-mail (regs.comments@federalreserve.gov)
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May 3, 2005

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Regs.Comments@FederalReserve.gov

**Re: Docket No. R-1226, Collection of Checks and Other Items by
Federal Reserve Banks, Regulations J and CC**

Dear Ms. Johnson:

Capital One Financial Corporation (“Capital One”) is pleased to submit comments regarding the Board’s Proposed Rule on the subject of transfer and presentment warranties with respect to remotely created checks.

Capital One Financial Corporation is a bank holding company whose principal subsidiaries, Capital One Bank, Capital One, F.S.B., and Capital One Auto Finance, Inc., offer a variety of consumer lending and deposit products. Capital One’s subsidiaries collectively had 49.1 million accounts and \$81.6 billion in managed loans outstanding as of March 31, 2005. Capital One is a Fortune 500 company and, through its subsidiaries, is one of the largest providers of MasterCard and Visa credit cards in the world.

Capital One appreciates the Board’s concerns relating to alleged fraudulent use of remotely created checks. However, Capital One believes that it is inappropriate to adopt the Proposed Rule in its current form, on the basis of current knowledge and industry practice. First, the Proposed Rule is not supported by current commercial practice or by evidence of the actual quantity of fraud associated with remotely created checks. Second, the Proposed Rule could plausibly increase fraud in some circumstances. And third, the Proposed Rule is inconsistent with the Board’s treatment of an analogous circumstance under the “Check 21” Act, which treatment we believe is more appropriate.

1. The Proposed Rule is not supported by commercial practice or by evidence of true fraud.

The Board's proposed creation of a warranty of authenticity by the presenting bank is based on the assumption that the absence of a signature on a remotely created check deprives the paying bank of the normal and customary ability to compare the signature with that on the customer's signature card in order to verify authenticity before paying. However, Capital One believes that, in the great majority of cases, paying banks do not make that comparison. In most cases, paying banks pay the checks presented without verifying the signature, unless a check presents pre-established risk factors such as high dollar amount. The factual predicate for the Proposed Rule, therefore, appears not to exist.

Further, as the Board notes in its Supplementary Information, little data is available about remotely created checks. Consequently it is impossible to know the actual extent of the problem that the Proposed Rule seeks to rectify. As the Board notes, many fraud claims can be cases of "buyer's remorse"; they may also be instances of intra-family fraud in which the facts of whether the payment instrument was actually authorized may be ambiguous. Capital One believes that the paying bank, which has the customer relationship, is in the best position to investigate claims and establish such issues. The Proposed Rule removes the paying bank's incentive to do that.

2. The Proposed Rule may increase fraud.

Under the Proposed Rule, when a fraud claim is made with respect to a remotely created check, the paying bank will reimburse the customer and then be reimbursed by the presenting bank under its warranty. When this practice becomes known, some persons may assert specious fraud claims in order to avoid or postpone payment, feeling less incentive to cooperate with the upstream parties who are liable to the paying bank on their warranties than they would with the paying bank itself. For example, remotely created checks are often generated in the course of collecting overdue accounts. Delinquent debtors may feel encouraged to make specious claims of fraud if the paying bank has no incentive to contest their claim.

3. The Proposed Rule is inconsistent with the Board's implementation of the "Check 21" Act.

Imaging of checks, authorized by the Check 21 Act, presents similar issues to that addressed by the Proposed Rule, in that sometimes security features do not survive the imaging process. The Board did not, however, automatically shift warranty liability to the presenting banks in such circumstances, but shifted responsibility only in those instances in which the paying bank's processes actually would have relied on the security features that

were lost in the imaging process, analogous to the lack of signature on the remotely created check. In that circumstance, the Official Staff Commentary to 12 C.F.R. §229.53 states:

- “a. [Example:] A paying bank makes payment based on a substitute check that was derived from a fraudulent original cashier’s check. The amount and other characteristics of the original cashier’s check are such that, had the original check been presented instead, the paying bank would have inspected the original check for security features. The paying bank’s fraud detection procedures were designed to detect the fraud in question and allow the bank to return the fraudulent check in a timely manner. However, the security features that the bank would have inspected were security features that did not survive the imaging process Under these circumstances, the paying bank could assert an indemnity claim against the bank that presented the substitute check.

- “b. By contrast with the previous examples, the indemnity would not apply if the characteristics of the presented substitute check were such that the bank’s security policies and procedures would not have detected the fraud even if the original had been presented. For example, if the check was under the threshold amount at which the bank subjects an item to its fraud detection procedures, the bank would not have inspected the item for security features regardless of the form of the item and accordingly would have suffered a loss even if it had received the original check”

Similarly, the warranty that the Board proposes with respect to remotely created checks should not attach to items in circumstances in which the paying bank would not have verified the signatures anyway, for example because they were under the dollar amount set by the paying bank for such purposes – which we believe most remotely created checks are.

For the foregoing reasons, we believe that the Board should not adopt the Proposed Rule. We observe that the warranty that the Board proposes is also the subject of proposed revisions to the Uniform Commercial Code, but that, as the Board notes, those revisions have not been adopted in the majority of states, and even in those states in which they have been adopted, they have not been adopted in a uniform manner. The Board infers from this that modifying Regulation CC to create the warranty is necessary to fill the supposed gap. We submit that the lack of uniform adoption of the UCC revisions may simply be further evidence that the case for the proposed warranty has not been made.

If the Board adopts the Proposed Rule, we submit that it should be adopted with these qualifications:

1. The rule should make clear that no additional warranty is made in connection with a remotely created check unless the paying bank can state that, under its written internal policies and procedures, the bank's security procedures would have examined the drawer's signature on the item.
2. The paying bank should be required to conduct a reasonable and diligent investigation, reasonably concluding that the remotely created check was not authorized by the depositor, prior to pursuing a claim for breach of the presentment warranty.
3. The paying bank should obtain a written affidavit executed by the depositor regarding the alleged fraudulent check, ideally in a standardized model form created by the Board.
4. Any final rule should include a provision similar to UCC §4-208(c) that prevents a paying bank from bringing warranty suits against prior parties if the paying bank could have asserted defenses against the depositor.

* * *

Capital One appreciates the opportunity to comment on the Proposed Rule. If you have any questions about this matter and our comments, please call me at (703) 720-2255.

Sincerely,

/s/

Christopher T. Curtis
Associate General Counsel
Policy Affairs and Legislative Counsel

CTC/slv