

From: Matthew O Beard

Subject: Collection of Checks and Other Item by FRB and Funds Transfers through Fedwire.

Date: Jul 26, 2004

Proposal: Regulation J - Collection of Checks
and Other Items by Federal Reserve Banks and FundsTransfers Through Fedwire
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Comments:

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

RE: Collection of Checks and Other Items by Federal Reserve Banks and
Funds Transfers through Fedwire (Docket No. R-1202)

Dear Ms. Johnson,

The Michigan Credit Union League (MCUL) appreciates the opportunity to provide comments to the Federal Reserve Board (FRB) concerning the FRB's proposal to incorporate changes created by Check 21 into Regulation J. The MCUL is a trade association representing over 90% of state and federally chartered credit unions in the state of Michigan. This comment letter was drafted in consultation with the MCUL Government Affairs Committee, which is comprised of Michigan credit union staff and officials.

MCUL appreciates the FRB's efforts to incorporate Check 21 changes into their existing regulations. MCUL is very supportive of FRB's efforts to create consistency within Regulation J and Check 21 requirements. We believe that creating consistency with Check 21 regulations for electronic payments that are not subject to Check 21 regulations makes sense as well. We request that it be clarified however, that the Reserve Banks are subject to the same warranties and indemnities for their mistakes as other financial institutions that send payments through them.

Summary of Comments

1. MCUL supports the extension of coverage of Regulation J, so that it covers electronic items as well as paper items. This would allow coverage of checks that have been converted to electronic files that pass through Federal Reserve Banks.
2. MCUL supports the incorporation of substitute check warranties and indemnities into Regulation J that Federal Reserve Banks and other banks will make under the Check 21 Act and subpart D when handling a substitute check or a paper or electronic representation of a substitute check. These Regulation J changes reflect changes to the checking system that Check 21 has created.
3. MCUL supports the additional warranties and indemnities that will apply to Federal Reserve Banks and other banks that send electronic items not otherwise covered by the Check 21 Act and subpart D.
4. MCUL supports the proposal to amend Regulation J to require a sender who sent an electronic item to a Reserve Bank to indemnify the Reserve Bank for losses that the Reserve Bank incurs when it makes an indemnity for an electronic item that it subsequently converts to a substitute check. However, we believe that it needs to be clarified that Reserve Banks should be subject to those same warranties for any mistakes that they make.
5. MCUL supports the extension of FRB recovery rights to receiving institutions of those electronic items.

Discussion

Support Extension of Coverage to Electronic Files. MCUL supports the extension of coverage of Regulation J, so that it covers electronic images of paper checks outlined under Check 21. This would allow coverage of checks that have been converted to electronic files that pass through Federal Reserve Banks to be subject to Regulation J requirements. We understand that Regulation J, by its own definitions, is limited and needs to be updated to reflect the new requirements created under Check 21. By changing the definition to reflect electronic items created from checks that pass through the Reserve Banks, this will allow Regulation J to remain current. In addition, we support the requirement for checks to maintain all current indorsements that have been provided as this parallels the same requirement made by Check 21. MCUL recognizes, and supports, uniformity among different related regulations whenever it is possible to help credit unions maintain compliance standards.

Check 21 Created Indemnities and Warranties. MCUL supports the incorporation of substitute check warranties and indemnities into Regulation J that Federal Reserve Banks and other banks will make under the Check 21 Act and subpart D when handling a substitute check or a paper or electronic representation of a substitute check. We support the addition of the warranty that requires that items presented to the FRB bears all indorsements applied by previous parties that handled the item for forward collection or return to facilitate compliance with Check 21. We also support the addition of language that would acknowledge explicitly that a sender makes the warranties and indemnities specified in subpart D of Regulation CC (which implements the Check 21 Act) when sending an item in the form of a substitute check, since these warranties would be made regardless of whether this was spelled out in Regulation J.

Additional Warranties for Electronic Items. MCUL supports the additional warranties that will apply to Federal Reserve Banks and other banks that send electronic items not otherwise covered by the Check 21 Act and subpart D. As it currently applies, a recipient of an electronic item that is not subject to the Check 21 Act (i.e., an electronic item that is not the result of Check 21 conversion) who chooses to convert the check to a substitute check would not receive the Check 21 Act warranties from the sending bank. The new amendments

would enable the FRB, in the event that they convert the item to a substitute check, to pass on the liabilities and indemnities to the sending institution.

The proposed changes to Regulation J would make each sender of an electronic item that is not a representation of a substitute check provide the Check 21 Act warranties to recipients of those electronic items. One concern that MCUL has is that some credit unions have relationships with other entities that are responsible for sending their payments to the Reserve Banks. We believe that it would make it extremely difficult for these payment vendors or other financial institutions to monitor all electronic entries that come through their institutions. We therefore recommend that it be clarified that the institution that is responsible for the origination of the electronic item should be responsible for any warranty and indemnity rights, not simply the sender of that item.

New Warranties for FRB on Electronic Items. MCUL supports the proposal to amend Regulation J to require a sender who sent an electronic item to a Reserve Bank to indemnify the Reserve Bank for losses that the Reserve Bank incurs when it makes an indemnity for an electronic item that it has subsequently converted to a substitute check. This would essentially allow the Federal Reserve to pass back Check 21 liabilities for items to the financial institution that is responsible for the original entry. As Check 21 currently stands, the institution that elects to convert a paper check into an electronic image takes on the additional warranties and liabilities associated with Check 21. In this case the converting institution would be the FRB, who would be providing warranties to the recipient of the electronic check. Since the FRB may not be responsible for any errors in the check, it would make sense that the institution that issued the original electronic payment should be responsible for these warranties.

However, MCUL requests that it be clarified that Reserve Banks be responsible for providing these same warranties to receiving financial institutions for any mistakes they are liable for in the electronic check conversion process. As the regulation currently reads, it seems that there can be interpretation that Reserve Banks would not be responsible for any mistakes made on their behalf. We believe that this is unfair to all financial institutions, in particular the financial institutions that would be responsible for resolving these mistakes. We ask that this be clarified in commentary, or spelled out in the regulation.

Extension of Recovery Rights. Since the MCUL supports the extension of Check 21 warranties outside of what is defined in Check 21 legislation, we also support these same protections being forwarded to receiving institutions of an electronic item that is not subject to the Regulation CC warranties. We believe that if additional protections are provided to Reserve Banks for electronic items, a receiving financial institution should be afforded these same protections. This would help clarify the warranty process and provide consistency for all payments channeled through the Federal Reserve.

We thank you for the opportunity to comment.

Sincerely,

Matthew Beard
Regulatory Specialist
Michigan Credit Union League

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