

July 26, 2004

Ms. Jennifer J. Johnson  
Secretary, Board of Governors  
Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, DC 20551

Dear Ms. Johnson:

The Georgia Credit Union League (GCUL) appreciates the opportunity to comment on the Federal Reserve Board's (FRB) proposal to amend subpart A of Regulation J to provide for the rights and obligations of sending banks, paying banks, returning banks, and Reserve Banks in connection with collection of substitute checks and items that have been converted to electronic form. The proposed changes would ensure that Regulation J covers the new check processing service options that the Reserve Banks plan to offer when the Check Clearing for the 21<sup>st</sup> Century Act (Check 21 Act) becomes effective on October 28, 2004.

GCUL is the state trade association and one member of the network of state leagues that make up the Credit Union National Association (CUNA). GCUL serves approximately 210 credit unions that have over 1.7 million members. This letter reflects the views of our Regulatory Response Committee, which has been appointed by the GCUL Board to provide input into proposed regulations such as this.

#### Background

Regulation J governs collection of checks and other items by the Reserve Banks. This subpart includes the warranties and indemnities that are given to the Reserve Banks by parties that send items to the Reserve Banks for collection and return, as well as the warranties and indemnities for which the Reserve Banks are responsible in connection with the items they handle.

Regulation J also authorizes the Reserve Banks to issue operating circulars governing the details of the collection of checks and other items and provides that such operating circulars have binding effect on all parties interested in an item handled by a Reserve Bank. The Reserve Bank's operating circular that is most relevant to the Reserve Banks' check collection activities is Operating Circular No. 3, "Collection of Cash Items and Returned Checks" (OC 3).

Under existing Regulation J, the term "item" is understood to mean a paper instrument. Although Reserve Banks in some cases accept, transfer, present, or return items in electronic form, the rights and obligations associated with handling items electronically currently are specified in OC 3, rather than in Regulation J.

Once the Check Clearing for the 21st Century Act (the Check 21 Act) takes effect on October 28, 2004, the Board expects that the Reserve Banks will offer a wider variety of services that involve handling items electronically. In addition, the Board expects that the Reserve Banks in some cases will act as “reconverting banks” that create substitute checks and provide the associated substitute check warranties and indemnity in accordance with the Check 21 Act and subpart D of the Board’s Regulation CC.

The proposed amendments to Regulation J primarily are designed (1) to cover the Reserve Banks’ handling of electronic items explicitly under Regulation J, (2) to acknowledge the substitute check warranties and indemnities the 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, and (3) to include new warranties and indemnities that will apply when Reserve Banks and other banks send an electronic item that is not otherwise covered by the Check 21 Act and subpart D.

The Board will make the following changes to Regulation J:

- The Board will expand Regulation J, so that its definition of item includes an electronic item, which would be defined as the electronic image of a paper item.
- The definition of paying bank will be revised so that it includes those institutions that pay on electronic items.
- The Board will clarify the entities that are considered senders under Regulation J by adding Federal Reserve Banks and U.S. branches and agencies of foreign banks as entities listed in that definition.
- The revised Regulation J will refer to Regulation D and Regulation CC by name and not in terms of their legal cites, such as “part 204 of this chapter”.
- The Board will clarify that terms not explicitly defined in Regulation J would have the meanings set forth in Regulation CC or the Uniform Commercial Code.

#### Summary of GCUL’s position.

The proposal extends the coverage of Regulation J, so that it covers electronic items as well as paper items. We support this change. Paper and electronic items should have the same rules as they relate to warranties and indemnification. Separate rules may yield consumer confusion and mishandling by financial institutions.

The proposal also acknowledges the substitute check warranties and indemnities the 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 these clarifications in Regulation J and feel that all three items should be treated the same for FRB and other banks.

We also support the proposed new warranties and indemnities that will apply when Reserve Banks and other banks send an electronic item that is not otherwise covered by the Check 21 Act and subpart D. For example, it 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 that later convert the item into a substitute check and incur a loss. Thus, these

--Page 3--

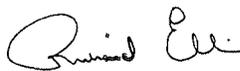
new warranties would allow the recipient of an electronic item to pass back liabilities incurred under the Check 21 Act but for which the recipient did not receive Check 21 Act protections. A recipient could incur these liabilities if the recipient converted the item into an electronic item.

Because it is the same treatment for paper checks, we support the proposal under Regulation J that would 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.

The Board also proposes that the Regulation specify that the Reserve Banks' recovery rights extend to any indemnity that the Reserve Banks provide under this regulation. We support this change, as the FRB serves as a clearing entity.

Thank you for the opportunity to comment on the proposed amendments to Regulation J. If you have questions about our comments, please contact Cynthia Connelly or me at (770) 476-9625.

Sincerely,

A handwritten signature in cursive script, appearing to read "Richard Ellis".

Richard Ellis  
Vice President/Credit Union Development