

JPMORGAN CHASE & CO.

Janice M. Havins
Vice President and
Assistant General Counsel
Legal and Compliance Department

May 27, 2011

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

Via: Agency Web Site: http://www.federalreserve.gov/generalinfo/foia/Proposed_Reqs.cfm

Re: Regulation CC Proposed Rule; Docket No. R-1409 and RIN No. 7100-AD68

Dear Ms. Johnson:

The Board of Governors of the Federal Reserve System (the "Board") has requested comments on its proposed amendments to Regulation CC ("Regulation CC"). JPMorgan Chase & Co. ("JPMorgan Chase"), on behalf of its main subsidiary bank, JPMorgan Chase Bank, National Association and its affiliates, appreciates the opportunity to submit this response.

JPMorgan Chase & Co. is a leading global financial services firm with assets of \$2.2 trillion and operations in more than 60 countries. The firm is a leader in investment banking, financial services for consumers, small business and commercial banking, financial transaction processing, asset management, and private equity. A component of the Dow Jones Industrial Average, JPMorgan Chase services millions of consumers in the United States and many of the world's most prominent corporate, institutional and government clients under its J.P. Morgan and Chase brands. Information about the firm is available at www.jpmorganchase.com.

JPMorgan Chase supports the Board's effort to facilitate the banking industry's ongoing transition to fully-electronic interbank check collection and return, including proposed changes to the expeditious return rules, updating the availability schedule provisions and model forms, as well as setting forth the broader requests for comment on future changes to the Regulation to improve the check collection system (the "Proposal").

JPMorgan Chase participated in the Electronic Check Clearing House Organization (ECCHO) sponsored calls to review and discuss the proposed section by section changes with its member banks and other interested

JPMorgan Chase & Co. • TX2-N045, 712 Main St. 4th Floor North, Houston, TX 77002

Telephone: 713 216 8070 • Facsimile: 713 216 4495

Janice.m.havins@chase.com

parties. ECCHO is the leading provider of rule coverage for electronic check image exchange between its member banks and through clearing houses that have adopted the ECCHO Rules, filling the gap in existing laws and rules for electronic check image exchange. ECCHO Rules do not apply to all exchanges of electronic check images. Therefore, modifying the Federal rules will provide broader coverage and a more consistent set of rules for those receiving, presenting, clearing and returning electronic check images and related information through the United States check processing system. JPMorgan Chase also participated in industry calls led by the American Banker's Association and The Clearing House Payments Law Committee regarding the Proposal.

In an effort to avoid duplicative comments for the Board's review, and in support of the thorough response by ECCHO, JPMorgan Chase's comments are limited to those areas of the Proposal where we have additional comments or we have a different position than ECCHO.

I. Response to Board's Overview in the Proposal

(1) Expeditious-return rule. In addition to ECCHO's comments and in support of the rationale set forth in the Board's Overview in the Proposal, JPMorgan Chase agrees that it is appropriate for the risk of non-expeditious return to rest with a depository bank that chooses not to accept electronic returns. Consistent with this rationale, the forward-collection test should be deleted. The alternative approaches for expedited return set forth in the Board's Overview have been discussed during the various industry calls and we believe they would be either too costly to establish or operationally not viable.

(2) Same-day settlement rule. The Proposal would allow a paying bank to require that checks presented for same-day settlement be presented as "electronic collection items" at the paying bank's deemed "electronic presentment point". The paying bank must have agreed to receive electronic collection items from the presenting bank under 229.36(a). We recommend that Section 229.36(d)(2) and its *Commentary* clarify that the timeframes, deadlines, and settlement methods established for paper same-day settlement apply to same-day settlement of electronic collection items, (i.e., presenting bank cannot be charged a fee and the items must be presented by 8:00am local time of the paying bank). The paying bank must make a reasonable effort to come to an agreement for electronic presentment of same-day settlement items. An agreement may be "deemed" to exist when a paying bank (a) has a direct agreement with the presenting bank for electronic collection items and has designated an electronic presentment point for same-day settlement, (b) has an agreement with a third party processor that processes electronic collection items for the presenting bank and has designated an electronic

presentment point for same-day settlement, or (c) belongs to an image exchange network or collecting bank arrangement that makes its forward collection services for electronic collection items generally available to the presenting bank and such network or collecting bank processes electronic collection items on a same-day settlement basis. A paying bank cannot charge the presenting bank for the electronic connection between the paying bank and an intermediary acting as paying bank's processor with regard to (b) and (c) above. If an agreement cannot be achieved with the paying bank, an industry model agreement should be established.

(3) Electronic items not derived from images of original paper checks. We agree with the Board's comments that banks processing electronically-created items should make the new warranties under Regulation CC applied to electronic collection items and electronic returns. We support further review of non-RCC electronically-created items, including their usage and whether they should be considered checks. JPMorgan Chase continues to recommend full coverage of remotely created checks (RCC) whether or not originating as paper items (Paperless RCCs) under Regulation CC. The Clearing House letter submitted to the Board on October 28, 2010, setting forth the position of its member banks, provides a detailed review of RCCs and the rationale for why RCCs should be covered as checks for Regulation CC purposes regardless of whether the items started as paper. The Board, after vetting the issue with the industry in 2006, provided a specific definition of a RCC as "a check that is not created by the paying bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn". A bank that transfers or presents a RCC warrants in Section 229.34(d) that the person on whose account the RCC is drawn authorized the issuance of the check in the amount stated on the check and to the payee stated on the check. For checks that are not RCCs, depository banks do not make such warranty.

It is generally assumed that the RCC warranty only applies to a check created by the payee or by the payee's collecting agent. However, as written, the RCC warranty could apply to a check that is created by a bill paying entity on behalf of the account owner on whose account the check was drawn. We recommend the definition of a RCC (Section 229.2(nn) of the Proposal) be modified to distinguish checks created by a payee or collecting agency from checks created by an account owner on whose account the item is drawn or by a bill payment service, debt consolidation services, or the like. In addition to such clarification, we recommend that the definition of "original check" (Section 229.2(gg) of the Proposal) be modified to include a RCC whether originating in paper form or not. If these changes are made, the RCC warranty would apply to only those checks created by the payee or its collecting agent and would apply whether created in paper form or not. In situations where a claim is made for breach of the RCC warranty, a copy of the image of the check can be manually reviewed to determine if it meets the definitional requirements of a RCC, namely no purported signature of the drawer. However, non-RCC

electronically created items are not readily identifiable from checks images derived from an original check, even upon manual review.

For non-RCC items, JPMorgan Chase agrees with the Board's position that if the depository bank presents or transfers an item that otherwise did not originate as a paper check ("electronically-created item"), the depository bank is in the best position to assume such risk and should make the warranties set forth in Section 229.34; namely, that the item is suitable for creating a substitute check and that a person will not be asked to pay the item if it has already been paid.

The RCC form of payment continues to be used. As previously stated in JPMorgan Chase's Comment Letter to the Board on RCCs in 2006, we are unable to provide statistical data on usage of RCCs by our customers (either as deposits or disbursements) because RCCs are not uniquely coded. In reviewing accounts with high volumes of returns, we do not find that RCCs are the issue. JPMorgan Chase creates RCCs on behalf of some of its customers who receive large volumes of payments. The usage by these customers has remained constant since 2006; however, the NACHA -The Electronic Payments Association has adopted a new repetitive telephone authorization rule, effective this September, which may reduce the number of RCCs we create for these customers. Notwithstanding this new NACHA rule, our understanding is that RCCs will continue to be used in circumstances where there is a well established relationship between the payee and the payor for this type of payment, the payor does not authorize an ACH debit to its account, or the payor may otherwise not subscribe to online bill payment services.

II. Responses To Board's Section by Section Changes in the Proposal

(1) 229.2(s) and 229.2(v) - New definitions of "electronic collection item" and "electronic return".

JPMorgan Chase supports these new definitions and the Board's position that such terms should cover the exchange of electronic check images and information where the sending and receiving bank have agreed to exchange such items. As ECCHO has indicated, because electronic collection items and electronic returns may be exchanged by various intermediary banks or networks before reaching the paying bank or depository bank, the language in this section should identify sending banks and receiving banks in the exchange relationship. JPMorgan Chase supports the requirement that the item be suitable for a substitute check, unless the banks exchanging the item agree to exchange "imperfect images" as that term is used in the industry standards.

- (2) **229.13(g)(1)(ii) - Notice of Exception Holds.** JPMorgan Chase strongly supports the added provision requiring a bank to send notices of exception holds electronically if its customer has agreed to accept such notices electronically. This will reduce the time for such notice to be received through the mail by several days.. We recommend that the timing be based upon when the bank "sends" the notice, not when the notice is "expected to be received" by the customer. If there is an established secure electronic connection, the bank should be required to send the notice electronically by the first business day following the day the facts become known to the bank or the deposit is made, whichever is later. Determining when a customer receives the notice would be difficult to monitor or manage and we feel the requirement that the notice be sent in this time frame should be sufficient to meet the spirit of this new provision. We also request that the *Commentary* be modified to include that the bank is not otherwise required to send paper notices. This would be in line with national efforts to "go green" as well.
- (3) **229.13(h)(4) - Availability of deposits subject to extended holds.** JPMorgan Chase recommends that a "reasonable period" of time for an extended hold on checks that are not drawn on the depository bank be three business days (for a total of five business days) instead of the proposed two business days. Even in a fully electronic check image clearing and return environment, some checks will require manual review and processing. Although the Reserve Banks receive "about 99.7 percent of checks deposited for forward collection electronically" and "97.1 percent of returns electronically", JPMorgan Chase continues to receive a significant number of returns beyond the proposed timeframe. We determined that for returns received outside this timeframe, most are received by the fifth day. Even in an electronic exchange environment, there may be (a) issues with electronic check images not meeting the recognized industry standards in the forward collection process including through an intermediary or network provider, (b) issues with the check images once presented to the paying bank, or (c) issues with processing the return electronically. Industry standards have been established for check image quality and electronic transmission and receipt of check data which the Board recognizes in its proposed changes and, if the industry standards are not met, delays may occur in the forward or return process even if both banks have agreed to process electronically. Therefore, we strongly recommend that the "reasonable period" be at least three business days (for a total of five business days).
- (4) **229.16(c)(2)(i) - Case by case holds.** In response to the Board's specific request for comment on whether banks continue to find such holds useful, JPMorgan Chase continues to place case by case holds on checks based upon established criteria designed to identify checks that are likely to be returned unpaid, substantially

reducing fraud losses. Retaining the ability to place case by case holds allows banks to accept a greater percentage of checks for deposit rather than reject the checks before knowing whether, in fact, the checks will be paid. Our systems analyze a deposit based upon predetermined criteria and if the system identifies an issue with a particular deposit, further research may be done to determine if a hold should be placed on the funds. These criteria are confidential so that deposits are not modified to evade detection.

- (5) **229.30(a) and (b) - Paying bank's responsibility for expeditious return.** We support the "two day test" for expeditious return and that a paying bank is not required to comply with such requirement if the depository bank has not agreed to accept electronic returns under 229.32(a). After thoroughly vetting this issue with other banks participating on industry group calls, JPMorgan Chase agrees that a clearer definition of what it means to have an agreement to accept electronic returns is needed. Based upon current practice, a majority of electronic returns go through the Federal Reserve Banks because it is impractical for every paying bank to establish a connection with every depository bank for electronic returns. It is more practical to recognize this connection to the Federal Reserve Banks for electronic returns in relation to a depository bank's agreement to receive electronic returns.

We support ECCHO's recommended option whereby a depository bank has an agreement for electronic return with the paying bank, and thus is entitled to expeditious return, if the depository bank: (a) has an agreement for electronic return directly with the paying bank, (b) has an agreement for electronic return through a returning bank which in turn has an agreement with the paying bank to accept electronic returns, (c) has an agreement for expeditious return by means of electronic return through the Federal Reserve Banks, regardless of whether the paying bank has an arrangement to send electronic returns to the Federal Reserve Banks, or (d) is a member of a clearing house or network and has agreed to receive electronic returns through that clearing house or network from the paying bank. We support recognition that an agreement to accept electronic returns can occur through clearing house rules if both banks are members. We also recommend the Board recognize that banks identify specific routing and transit numbers for electronic check image exchange, so that an agreement is not necessarily at a bank-wide level for all routing and transit numbers assigned to that particular bank.

- (6) **229.30(c) - Extension of deadline for Expeditious return of checks.** JPMorgan Chase supports the extension of time to return a check to the time of dispatch if the paying bank uses a means of delivery that would ordinarily reach the depository bank by 4:00 p.m. on the second business day after the banking day on which the check was presented to the paying bank. The Board requested two comments on this section: (a)

we support requiring the paying bank to bear the risk that the returning bank may not return the check expeditiously in situations where the paying bank has otherwise missed the midnight deadline for return and is sending the return through a returning bank, and (b) we support requiring that the return actually "reach", the depository bank by the extended deadline.

(7) **229.30(d) - Commentary on Refer to Maker.** JPMorgan Chase strongly opposes stating in Regulation CC that "refer to maker" is an invalid return reason. Current *Commentary* to 229.30(d) provides that the return reason "refer to maker" is permissible in appropriate cases. Refer to maker is a well-established return reason in the industry, and we do not see abusive use of this return reason. It is the most appropriate language to use in situations where the depositor is referred back to the issuer to resolve an issue regarding the underlying transaction and in situations where the person (or bank) returning the check does not have access to sufficient facts to make a final determination of fraud before meeting its return deadline obligation. Under the Uniform Commercial Code, a paying bank has no duty to the holder or a presenting bank to honor a check (other than a certified check) or to justify its dishonor of a check. A paying bank's duties in this regard run only to its customer, the drawer of the check. Therefore, if the paying bank or its drawer customer wishes to refer the presenter of the check back to the drawer customer, they should be permitted to do so. No other return reason used today has been specifically ruled an invalid return reason. There is no definitive list of all possible return reasons in use in the industry today. We are not aware of complaints from our customers who receive returned checks with this reason or of any abusive use of this return reason. Further, it would be costly to attempt to eliminate this return reason in industry standards, banks' return code systems and customers' own systems which receive and process return reason information on both deposits and disbursements. For these reasons, JPMorgan Chase strongly requests that the original language in the *Commentary* remain unchanged.

(8) **229.30(e) - Notice in Lieu of Return.** JPMorgan Chase supports the industry practice established for processing notices in lieu of return in situations where the paying bank is unable to provide an electronic return. We request that the rules clarify that a sending bank should send such notice of return as an administrative or non-monetary return and not otherwise as a "notice" outside of the bank's normal check processing flow. If the notice in lieu of return is sent outside of the normal check process flow, the depository bank may have difficulties associating the information contained in the notice with the deposited item, creating delays in posting the return and additional risk to the depository bank if it is unable to charge back the return in a timely manner.

- (9) **229.31(a)(4) - Qualified returns extension.** JPMorgan Chase supports the continued ability to use carrier envelopes for automated return of certain checks. Circumstances continue to exist where returning banks may not be able to create an electronic return.
- (10) **229.32(a)(1) - Circumstances when the depository bank agrees to accept electronic returns and Commentary.** With regard to circumstances in which a returning bank “holds itself out” as accepting electronic returns, JPMorgan Chase recommends the criteria set forth in our comments to 229.30(a)(1) should be the standard. We do not support establishing a published list or other centralized location.
- (11) **229.32(a)(2) - When an electronic return is “received” and 229.36(a)(2) - When an electronic collection item is “received”.** With regard to the reference to e-mail addresses, there is no capability for an IP address or an e-mail address to be included in the electronic file based upon current industry standards. Therefore, JPMorgan Chase requests these sections be modified to provide that if an e-mail address or IP address will be designated as the place for receipt of either an electronic return or an electronic collection item, there must be an agreement between the parties.
- (12) **229.34(a) - Transfer and presentment warranties for “electronic collection item” and “electronic return”.** The warranties regarding transfer and presentment of electronic collection items and electronic returns should be limited to the parties exchanging these items through the check clearing and return process and should not be extended to the drawer or the owner of the check.
- (13) **229.34(e) - Transfer and Presentment warranties for Electronically Created Items.** The Board refers to “electronically-created items” as checks that did not originate as paper checks. All warranties set forth in Section 229.34 apply to electronically-created items as if they qualified as electronic collection items or electronic returns. Section 229.34 warranties require that each bank that transfers or presents an electronic collection item or an electronic return and receives settlement or other consideration for it warrants that (i) the image accurately represents all information on the front and back of the original check when it was truncated, the electronic information contains an accurate record of all MICR line information required for a substitute check and the amount of the check and (ii) no person will receive a transfer, presentment or return of or otherwise be charged for an electronic collection item, an electronic return, the original check, a substitute check or a paper or electronic representation of a substitute check such that the person will be asked to make payment on a check it has already paid.

As set forth in our response to the Board's Overview in paragraph I (3) above, JPMorgan Chase agrees that the warranties of 229.34 should apply to electronically-created items, but that such items (other than Paperless RCCs) should not be defined as checks under Regulation CC.

(14) **229.36(b) - Permits a paying bank to require forward collection items be separated from returned checks.** JPMorgan Chase supports banks having the ability to require the separation of forward collection items from returns. This is important for back-office processing in a timely and effective manner.

(15) **229.36(d)(2) - and Commentary--Same-day settlement rule.** We support ECCHO's comment regarding the right to require separate SDS locations from other electronic collection item presentment. Further comments are set forth in our response to the Board's Overview in paragraph I (2) above.

III. Additional Comment

Effective Dates. We support the recommended effective dates. However, if "refer to maker" will be identified as an invalid return reason, we request that such change not take effect for at least twenty-four (24) months for the reasons stated in paragraph II (7) above.

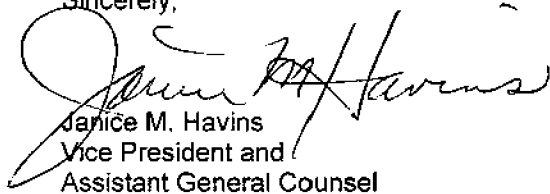
Midnight Deadline. In response to the Board's specific request, JPMorgan Chase does not believe the midnight deadline should be changed. There continue to be checks that require manual review or intervention during the return process.

Evidentiary Issue regarding Copies of Check Images. A specific evidentiary issue related to the truncation and clearing of electronic collection items (or substitute checks) has arisen in check fraud law suits where only a copy of a check image, not the original check, is presented as evidence. The law currently allocates responsibility for the loss associated with check fraud between the paying bank and the depository bank based on a determination of whether the original check was altered or whether the check was a counterfeit item. Prior to the rapid adoption of electronic check image exchange, the original check was presented as evidence and expert testimony based upon handwriting analysis and other forensic testing of the original check would be provided. Courts would use such testimony as a basis for determining liability. Because checks are now truncated and processed as either electronic collection items or substitute checks, copies of check images and not the original checks are provided as evidence without the referenced expert testimony. Courts presented with similar evidentiary issues have reached different conclusions on

whether the check should be deemed to be an alteration of the original or a counterfeit. We believe the Board, through Regulation CC should create an evidentiary presumption to remove this uncertainty. It is more appropriate that the presumption be that the original check was altered and not a counterfeit, placing the burden on the depository bank to overcome such presumption, for the following reasons: (a) the paying bank does not have the right to demand presentment of the original check, (b) the vast majority of checks are truncated by the depository banks or their customers, (c) the depository bank has the option of retaining the original check, and (d) the depository banks' customers received the funds related to the fraudulent check claim. We request the Board's further consideration of this issue and proposed solution.

JPMorgan Chase & Co. appreciate the opportunity to comment on these important changes to Regulation CC and welcome any requests to discuss the points raised in our response. Should you have any questions, please contact Janice Havins at (713) 216 8070.

Sincerely,



Janice M. Havins
Vice President and
Assistant General Counsel

Enclosure



October 28, 2010

Louise L. Roseman
Director
Division of Reserve Bank Operations and Payment Systems
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Re: Proposed Amendment to Regulation CC to Address Paperless Remotely Created Checks

Dear Ms. Roseman:

The Clearing House Association L.L.C.¹ (“The Clearing House”) respectfully submits for consideration by the Board of Governors of the Federal Reserve System (the “Board”) the proposed amendments to Federal Reserve Regulation CC² (“Regulation CC”) and Federal Reserve Banks Operating Circular No. 3³ set forth below to provide for clear treatment under the law of remotely created checks (“RCCs”) that are never reduced to paper items (“Paperless RCCs”).

I. Issue

An RCC is a type of check that is drawn on the account of the payor but that is not created by the paying bank and that is not signed by the payor.⁴ Instead of the payor’s signature,

¹ Established in 1853, The Clearing House is the nation’s oldest banking association and payments company. It is owned by the world’s largest commercial banks, which employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association is a nonpartisan advocacy organization representing through regulatory comment letters, amicus briefs and white papers the interests of its owner banks on a variety of systemically important banking issues. The Clearing House Payments Company provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House’s web page at www.theclearinghouse.org.

² Regulation CC, 12 C.F.R. § 229, *et seq.*

³ Federal Reserve Banks Operating Circular No. 3, Collection of Cash Items and Returned Checks, Effective July 15, 2008.

⁴ Specifically, Regulation CC defines a “remotely created check” as “a check that is not created by the Paying Bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn.” Regulation CC, 12 C.F.R. § 229.2(ff).

an RCC generally bears a statement that the payor authorized the check. The 2006 amendments to Regulation CC expressly defined and addressed RCCs that are printed prior to their deposit with the depository bank ("Paper RCCs"). Increasingly, however, financial institution customers are leveraging technological advances ushered in by the Check Clearing for the 21st Century Act⁵ ("Check 21") to deposit RCC images with the depository bank. According to our members, when depository banks accept deposits of RCCs in image rather than in physical (paper) form, it becomes very difficult, if not impossible, for the depository bank to determine whether the image was derived from a Paper RCC or rather originated as a Paperless RCC. Paperless RCCs, while often indistinguishable from Paper RCCs to the depository bank and to any transferring, presenting or paying bank, have uncertain legal status because, as currently defined under Regulation CC, an RCC must be reduced to paper, if even for a moment, in order to achieve definitional status as a "check" under federal law. The uncertain legal status of Paperless RCCs is leading to increased market confusion as well as undue and unnecessary burden on depository banks.

II. Background

A "check" is defined under Regulation CC as one of four types of demand draft, a United States Postal Service money order or a traveler's check, and also expressly includes an original check and a substitute check.⁶ Regulation CC relies on the Uniform Commercial Code ("UCC") for the definition of "draft," which is defined as "a *written* instruction to pay money signed by the person giving the instruction."⁷ The term "original check" is defined in Regulation CC as "the first *paper* check issued with respect to a particular payment transaction,"⁸ and the term "substitute check" is defined as "a *paper* reproduction of an original check. . . ."⁹ Consequently, to qualify as a "check" for purposes of Regulation CC, an item must have taken paper form at some point in its lifecycle (including if an image of the item is to serve as the basis for creation of a legally valid substitute check). The Board amended Regulation CC on July 1, 2006 to expressly define and address RCCs, including by creating transfer and presentment warranties

⁵ 12 U.S.C. §§ 5001–5018.

⁶ Regulation CC, 12 C.F.R. § 229.2(k).

⁷ U.C.C. §§ 3-103 & 3-104.

⁸ *Id.* at § 229.2(vv) (emphasis added).

⁹ *Id.* at § 229.2(aaa).

for RCCs that shift liability for unauthorized RCCs to the depository bank.¹⁰ Recognizing the increased use of imaging supported by Check 21 to deposit RCCs, the Board revised Operating Circular No. 3 on July 15, 2008 to distinguish data collected from a Paper RCC (which is eligible for forward collection through the Reserve Bank) from data collected from a Paperless RCC (which is ineligible for forward collection), stating:

Data sent to a Reserve Bank in the form of an electronic item is not an “electronic item” unless the data was captured from a check. By definition, the check from which the data was captured must be paper.¹¹

III. Proposed Amendments

Given their exclusion from coverage under Regulation CC and Operating Circular No. 3, the legal status of Paperless RCCs is uncertain because they are not clearly subject to check law even though Paperless RCCs (1) are rarely distinguishable from images captured from Paper RCCs (which are subject to check law), (2) offer better image quality and greater efficiency than is possible when RCCs are required to be printed prior to image capture and processing, and (3) pose no apparent enhanced risks of fraud or other loss relative to Paper RCCs because both instruments are based on authorization rather than payor signature.

The Board amended Regulation CC to place responsibility for the validity of RCCs on the depository bank because the depository bank’s relationship with the payee who deposited the item puts the depository bank in the best position to protect against fraudulent or unauthorized RCCs. Given that the validity of both Paper RCCs and Paperless RCCs is predicated on separate payor authorization and that neither type of item contains a payor signature or other verifiable indication on its face that payment has been authorized, the printing of an RCC does not enhance a depository bank’s ability to determine whether the RCC is fraudulent or validly authorized. Moreover, pursuant to the Regulation CC transfer and presentment warranties, if Paperless RCCs are treated the same as Paper RCCs, liability for losses attributable to an unauthorized Paperless RCC would rest with the depository bank, just as with Paper RCCs.

¹⁰ Collection of Checks and Other Items By Federal Reserve Banks and Funds Transfers Through Fedwire and Availability of Funds and Collection of Checks, 12 C.F.R. Parts 210 and 229 Regulations J and CC; Proposed Rule, Docket No. R-1226, 70 Fed. Reg. 10,509 (March 4, 2005).

¹¹ Operating Circular No. 3, *supra* note 3 at § 1.3(d).

According to our member banks, it is virtually impossible for depository banks to identify and intercept Paperless RCCs while allowing the legitimate deposit of images captured from Paper RCCs. Moreover, the process by which a Payee must print and scan a Paper RCC threatens the quality of the image at both the printing and scanning stages and could result in an illegible or poor quality image that cannot be processed efficiently if at all. Allowing the Payee to instead transmit the original image or Paperless RCC would avoid the need for reimaging and reprocessing of poor quality images and maximize the probability that a high quality image is submitted for processing. Additionally, allowing for the deposit and processing of Paperless RCCs would avoid the cost and time required to print and scan a Paper RCC solely for the purpose of creating a new image that was captured from a physical item.

Further, there is little reason to burden depository banks with the task of trying to distinguish Paperless RCCs from Paper RCCs or requiring Payees to print and scan a Paper RCC before depositing the image as there appears to be no incrementally increased risk or harm created by treating Paperless RCCs on equal footing with Paper RCCs under check law. Rather, requiring a payee to create a Paper RCC to serve as a physical item for image capture rather than allowing the deposit of the RCC as a Paperless RCC may actually increase risk. Specifically, printing an RCC creates a paper item that may be more susceptible to unauthorized access due to the additional handling and physical disposition required of the Paper RCC relative to a Paperless RCC. In addition, generating a Paper RCC and scanning the item rather than depositing the RCC as a Paperless RCC increases the risk of duplicate item presentment. Printing and scanning an RCC to create an image for deposit results in two live items, one electronic and one paper, and thereby increases the risk that both the image and the Paper RCC may be presented for payment and that the Paper RCC may be scanned and deposited multiple times. These risks would be mitigated if the payee were permitted to deposit the Paperless RCC directly with the depository bank.

For the foregoing reasons, we propose that the Board amend Regulation CC and Operating Circular No. 3 to afford Paperless RCCs the same treatment as the Board afforded to Paper RCCs through the 2006 Amendments to Regulation CC.

A. Regulation CC

We recommend that the definition of "original check" in Section 229.2(ww) of Regulation CC be amended as follows:

Original check means the first paper check issued with respect to a particular payment transaction: or a remotely created check whether or not originated as paper.

Adopting the proposed amendment to the definition of "original check" to include RCCs "whether or not originated as paper" will accord Paperless RCCs status as valid "checks" under Regulation CC, a necessary predicate to the valid processing of such items under Operating Circular No. 3. Paperless RCCs would remain RCCs, subjecting the depository bank to the transfer and presentment warranties associated with such items. Moreover, amendment of the definition of "original check" to include RCCs "whether or not originated as paper" will bring paper reproductions of Paper RCCs and Paperless RCCs within the meaning of "substitute check" under Regulation CC, and thus bring such paper reproductions within the substitute check warranties and substitute check indemnity provisions of Regulation CC. These provisions are among the terms relied upon in Federal Reserve Regulation J and Operating Circular No. 3 in determining check and item handling rights and responsibilities of the Reserve Banks. Thus, revising the definition of "original check" under Regulation CC to include RCCs "whether or not originated as paper" would enhance continuity and consistency among Regulation J, Operating Circular 3 and Regulation CC in the treatment of Paper RCCs and Paperless RCCs, while lifting the unnecessary burden on depository banks of performing the virtually impossible task of identifying and intercepting Paperless RCCs and eliminating the added risks of unauthorized access and duplicate presentment created by requiring that all RCCs be reduced to paper.

B. Operating Circular No. 3

We recommend that the definition and description of "electronic item" as set forth in Section 1.3(d) of Operating Circular No. 3 be amended as follows:

- (d) data captured from a cash item or a returned check may be sent in the form of an "electronic item," (as that term is defined in Regulation J). To meet the definition of an electronic item, the data must include an electronic image of

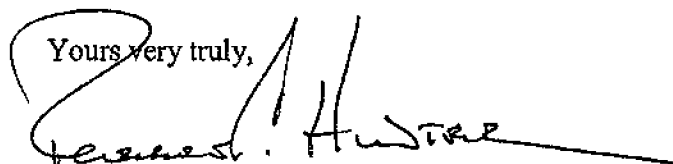
a check and information describing that check and must conform to the Reserve Bank's technical requirements for processing electronic items, as amended from time to time. Data sent to a Reserve Bank in the form of an electronic item is not an "electronic item" unless the data was captured from a check. ~~By definition, the check from which the data was captured must be paper.~~ A "purported electronic item" means an electronic image of a check and information describing that check that are sent to the Reserve Bank to be handled as an electronic item but that fail to conform to the Reserve Bank's technical requirements for processing electronic items.

Combined with the proposed changes to Regulation CC above, such amendment will bring Paperless RCCs within the meaning of an "electronic item" eligible for forward collection pursuant to Operating Circular No. 3.

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Thank you for your consideration and review of this proposal. We would like to meet with you and your staff to discuss the proposal in detail and I will be calling in the near future to determine a convenient meeting time. We look forward to working with you on this issue.

Yours very truly,



Robert C. Hunter
Senior Vice President & Senior Counsel

cc: Stephanie Martin, Associate General Counsel