



January 9, 2003

Check 21 Regulation

EXECUTIVE SUMMARY

The Federal Reserve Board (“Federal Reserve” or “Board”) has written the regulations for the Check Clearing for the 21st Century Act (“Check 21” or “Act”), and requests comments on these regulations by March 12, 2004. Check 21, which becomes effective on October 28, 2004, is intended to:

- Allow financial institutions to decide voluntarily to send checks electronically to each other, and
- Allow any financial institution that does not want to receive an electronic check to request a paper copy of the electronic check file, which is called a “substitute check.”

The regulations for Check 21 outline the following:

- The requirements of Check 21 that apply to financial institutions;
- Model disclosures and model notices regarding substitute checks;
- Endorsement and identification requirements on substitute checks for the financial institutions that truncate and convert electronic checks into substitute checks; and
- Changes to existing provisions of the Regulation CC and its commentary.

Credit unions will be affected by these regulations because they mandate new disclosures and create potential liability for them when their members handle “substitute checks.” Although most credit unions truncate and those that do will have limited contact with substitute checks, all credit union members use substitute checks in certain ways that trigger the new disclosures and liability rules. Specifically, for those credit unions that do not return share drafts to their members, the disclosure rules and special expedited recredit rules will apply to a member who deposits the check of a third party, if that check bounces and is returned in the form of a substitute check to the member. These provisions will also cover members who request a copy of their share draft and receive a substitute check. Of course, for those credit unions that do return share drafts, the new disclosures will apply to all their members and the expedited recredit rights will apply when those members receive substitute checks.

Please feel free to fax your responses to CUNA at 202-638-7052 **by Tuesday, February 24th**; e-mail them to Associate General Counsel Mary Dunn at mdunn@cuna.com and to Assistant General Counsel Michelle Profit at mprofit@cuna.com; or mail them to Mary

and Michelle in c/o CUNA's Regulatory Advocacy Department, 601 Pennsylvania Avenue, NW, South Building, Suite 600, Washington, D.C. 20004-2601. You may also click here for a full copy of this comment request:

<http://www.federalreserve.gov/BoardDocs/Press/bcreg/2003/20031222/default.htm>

Credit unions can send comments directly to the Federal Reserve. Comments should refer to docket number R-1176, and should be addressed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System. Comments may be mailed to 20th Street and Constitution Avenue, N.W., Washington, D.C., 20551; faxed to the Office of the Secretary at 202/452-3819 or 202/452-3102; or mailed electronically to regs.comments@federalreserve.gov. The Board asks commenters to consider fax or email since paper mail to the Board is subject to delay.

BACKGROUND

Check 21 was signed into law on October 28, 2003, and it will become effective on October 28, 2004. The law is designed to facilitate the electronic exchange of checks by making processing of electronic checks voluntary and not mandatory. The law does not mandate that all financial institutions be willing to accept electronic checks, but all institutions must accept a "substitute check," which is the paper copy of the electronic check file.

Check 21 establishes the law for the creation and exchange of substitute checks. This Act covers all checks and makes all checks eligible for conversion, including: consumer and business checks, Treasury checks, official checks, teller's checks and traveler's checks. Although the Act allows for the exchange of electronic checks, it does not mandate that financial institutions accept these electronic images. A depository institution can request a paper copy of the electronic check called a substitute check, but it must accept that substitute instead of the original. The limits on Check 21 are that it does not affect: (1) arrangements that credit unions have with members not to truncate their checks, or (2) bi-lateral or multi-lateral arrangements between depository institutions whereby depository institutions agree to exchange images of checks instead of paper checks.

SUMMARY OF THE LEGISLATION AND REGULATION

Overview of New Subpart D and Associated Amendments to Subpart A

The proposed regulation on Check 21 would be placed within Regulation CC (the Board's regulation on checks) in a new subpart D and would include the requirements of Check 21 that affect financial institutions that create or receive substitute checks or paper or electronic representations of substitute checks. Subpart D contains the following provisions: requirements of a substitute check must meet to be the legal equivalent of an original check; reconverting bank duties; the warranties and indemnity associated with substitute checks; expedited recredit procedures for consumers and banks; liability for violations of subpart D; the interaction between subpart D and existing federal and state laws; and the consumer awareness disclosure and other notices regarding substitute checks.

The Board also proposes to supplement some existing definitions in § 229.2, which have different definitions in Check 21 and to define several new terms used in subpart D. The Board also proposes to amend the magnetic ink character recognition (MICR) line requirements for qualified returned checks to allow for differences to facilitate the

processing of substitute checks and to amend § 229.35 and appendix D to include endorsement and identification standards for substitute checks. The Board also proposes revisions to several other parts of Regulation CC and its commentary.

Below, the summary discusses the proposed regulation by topic.

Definitions

The Board proposes two types of amendments to the definition section of Regulation CC. First, the Board proposes to amend some existing defined terms to account for differences between those definitions and the definitions within Check 21. Second, the Board proposes to define new terms used in subpart D. No amendments are necessary for those terms that are defined identically in Regulation CC and Check 21.

Subpart D amends the following definitions found in Regulation CC to clarify how those definitions are different under subpart D:

- **Account.** Check 21 defines the term account to mean any deposit account at a bank; therefore, it is much broader than the existing definition in Regulation CC, which essentially is limited to accounts that permit frequent transfers and withdrawals. The Board amends that definition to specify that the existing definition does not apply to subpart D and to state the broader definition for that subpart.
- **Bank.** The Board proposes to amend the existing definition and its commentary to incorporate the broader definition of a bank for purposes of subpart D. This definition includes financial institutions such as credit unions and the US Treasury and the US Postal Service to the extent that they act as payors.
- **Check.** The proposed commentary to this definition states that a substitute check meets the requirements of a “check” for purposes of all provisions of Regulation CC.
- **Forward collection.** Check 21’s definition is substantively the same, but includes a clause noting that sending a check to a collecting bank for settlement can be a component of forward collection.
- **Paying bank.** The proposed regulation adds the U.S. Treasury and the U.S. Postal Service to the definition.
- **Qualified returned check.** The proposed amendment would, in accordance with the generally applicable industry standard for substitute checks, require a “5” in position 44 if the qualified returned check is a substitute check. The “5” would ensure that the size of the image of the original check would remain constant on subsequent substitute checks.
- **State.** The Board proposes to supplement the existing definition of state by including additional entities.

Subpart D also adds the following definitions:

- **Claimant Bank.** Means a financial institution that seeks a claim for recredit.
- **Collecting bank, consumer, customer, and indemnifying bank.** The Board proposes to define these terms in the same way they are defined within the Act.
- **Magnetic ink character recognition (MICR) line.** The Board proposes to incorporate Check 21’s definition of MICR line. The commentary would note that the American National Standard Specification (ANS) for Placement and

Location of MICR Printing is the governing standard for MICR lines of original checks and substitute checks, and that ANS X9.90 has some additional requirements regarding the content of the MICR line of a substitute check.

- Original check. The Board proposed to define the term original check as the first paper check issued.
- Person. The Board will use the definition of a person in Check 21.
- Reconverting bank. The Board proposes to define reconverting bank to be (1) the bank that creates a substitute check or (2) with respect to a substitute check created by a person that is not a bank, the first bank that receives the substitute check and that transfers, presents or returns the substitute check or, in lieu of that substitute check, the first paper or electronic representation of that substitute check. The proposed commentary to this definition provides further clarification as to when and where creation of a substitute check occurs and explains that a bank need not accept a substitute check that was created by a nonbank and that has not yet been handled by a bank, unless the bank agrees to do so. Moreover, the proposed commentary provides examples of when a bank would be a reconverting bank under the definition and notes that there could be multiple reconverting banks with respect to the same payment transaction if a check moves from electronic form to substitute check form multiple times throughout the collection and return process.
- Substitute check. The proposed definition incorporates the definition found in Check 21. The regulation also specifies that:
 - An electronic check image that has not been printed is not a substitute check.
 - The MICR line of a substitute check can vary in ways established by ANS X9.90.
 - An original check with an encoding error in the amount field that becomes a substitute check with that error is a valid substitute check.
 - A reconverting bank or another bank could repair the MICR error cited above in that substitute check and that would not affect its status as a substitute check.
 - An item that perpetuated a MICR-read error would not be a substitute check as defined in this regulation. However, the Board proposes that, when such a noncompliant item purports to be a substitute check, the substitute check warranties, indemnity, and recredit rights would apply to that item as if it were a substitute check, even though it would not be the legal equivalent of the original check.
 - Sufficient copy and copy. The Board proposes to define a sufficient copy to be a copy of an original check that accurately represents the information on the front and back of the original check as of the time of truncation or otherwise is sufficient to determine the validity of a claim. A copy would be defined as a paper reproduction of a check. The proposed commentary to these terms reiterates that an electronic check image that appears on a computer screen is not a copy.
 - Transfer and Consideration. Check 21 warranties, which are a precondition for the legal equivalence of a substitute check, and the indemnity, are given when a substitute check or representation thereof is transferred, presented, or returned for consideration. The definition

clarifies that Check 21 explicitly provides that a drawer receives the substitute check warranties if it receives a substitute check or a paper or electronic representation of a substitute check. Check 21 also provides that a drawer, who suffers a loss due to the receipt of a substitute check instead of the original check, receives an indemnity. The proposed rule would explicitly exclude from the definition of consideration, the transfer of a substitute check solely in response to a claim related to that substitute check.

- Truncate. The Board adds the Act's definition.
- Truncating bank. The Board proposes to define truncating bank to be the bank that truncates the original check or, if a person other than a person truncates the check, the first bank that transfers, presents, or returns the check in a form other than the original check.

The Board proposes two amendments. These amendments would specify that a qualified returned substitute check must contain a "5" in a position 44 of the MICR line, whereas a qualified returned original check must contain a "2" in that position. A substitute check must contain a different number to ensure that the image of the original check remains a constant size.

Indorsements

Currently, banks generally print or "spray" endorsements on original checks when the checks are processed through the banks' automated check sorters. A substitute check will contain previous endorsements physically applied to the original check by preserving the image of the back of the original check. In addition, the reconverting bank will print, or "overlay" on the back of the substitute check, any previous endorsements that were applied to the original check electronically and the reconverting bank's own endorsement. Banks handling checks downstream from reconverting banks generally will process a mix of original checks and substitute checks through their sorters and spray endorsements on both.

The Board believes that in light of technical constraints, existing check sorting equipment will not be able to modify in real time, the location of the indorsements that the equipment sprays onto a check based on whether the check is an original check or a substitute check. The Board therefore proposes that the appendix's current location specifications would apply to endorsements printed on original checks and endorsements printed on existing substitute checks. Banks that do not create substitute checks generally would comply with the amended appendix D requirements by indorsing original checks and existing substitute checks exactly as they indorse original checks today. However, the Board proposes to amend appendix D to include new endorsement locations with which a reconverting bank must comply when it creates a substitute check. These locations would conform to ANS X9.90's location specifications for endorsements applied to a substitute check by a reconverting bank. The Board commentary would make the reconverting bank bear the liability for any loss that results due to the shift in the placement of the endorsement (e.g., illegible endorsements). The Board proposes to require all endorsements, including the depository bank endorsement, to be printed in black ink.

The Board proposes to permit but not require the inclusion of the depository bank's name and location in its endorsement.

The Board proposes to amend appendix D to require returning bank endorsers to comply with the same endorsement requirements as collecting banks. Specifically, the Board proposes to require that a subsequent collecting bank or returning bank endorsement be applied to the back of a check and include only (1) the bank's nine-digit routing number, and, if the returning bank is a reconvertible bank with respect to the check, an asterisk at each end of the number to identify the bank as a reconvertible bank, (2) the endorsement date, and (3) an optional trace or sequence number. The Board requests comment on what benefits, if any, there would be in providing returning banks with the flexibility to endorse on the front of checks and to include additional information in their endorsements.

The Board proposes to amend appendix D and to require a paying bank that is also a reconvertible bank with respect to a substitute check to identify itself as such by placing on the back of the check, its nine-digit routing number (without arrows) and an asterisk at each end of the number. This identification would not constitute an endorsement.

Requirements and Characteristics of Substitute Check

Check 21 establishes the basic requirements for a substitute check. The substitute check must:

- contain an image of the front and back of the original share draft/check;
- bear a MICR line with all the information from the original;
- conform to the industry standards for substitute checks; and
- be as suitable for automated processing as the original.

In Check 21, if the substitute check meets the requirements below, then it also becomes the legal equivalent of the original paper check for all purposes under federal and state laws (such as the Uniform Commercial Code and Regulation CC). The requirements for legal equivalence are that the substitute check:

- include an accurate representation of the front and back of the original check; and
- bear a legend that states, "This is a legal copy of your check. You can use it the same way you would use the original check."

According to the proposed rule, a bank warranty is another prerequisite of legal equivalence. The proposed rule makes this explicit by providing that a substitute check for which a bank has provided the substitute check warranties is the legal equivalent of the original check for all purposes and all persons if it meets the accuracy and legend requirements.

In addition, the proposed commentary reiterates that a substitute check created by a person other than a bank can be transferred only by agreement unless and until a bank makes the substitute check warranties with respect to that check. The commentary provides clarification about what information on the check must be accurately represented as a prerequisite for legal equivalence. Finally, the commentary states that the legal equivalence legend must use the language specified in that section.

However, the proposed rule provides that the recipient of an item that purports to be but is not a substitute check (e.g., a substitute check with the wrong MICR line) has warranty and indemnity rights, and, where applicable, recredit and consumer awareness disclosure rights under subpart D as though the item were a substitute check. The Board requests comments on whether an item that fails to meet any of the other substitute check requirements also should be treated as though it were a substitute check for those limited purposes.

Reconverting Bank Duties

The reconverting bank, the bank that turns an electronic file into a substitute check, must ensure that the endorsement of everyone (including itself) handling the check is on it for forward collection and return. This includes the endorsement of those handling the check in electronic, original or substitute form.

The proposal contains the reconverting bank duties in Check 21 regarding endorsements and identifications. The rule also requires a reconverting bank to identify the bank that truncated the original checks. The rule requires the reconverting bank and truncating bank identifications to be applied in accordance with generally applicable industry standards and with appendix D of Regulation CC.

The proposed commentary provides that, although a reconverting bank is responsible for preserving all previously – applied endorsements, it is not responsible for obtaining endorsements that should have been applied but were not. Some previously applied endorsement will be preserved because they will be shown on a substitute check’s image of the back of the original check, whereas the reconverting bank must physically apply to the back of the substitute check, any previous endorsements that were applied electronically. The proposed commentary also makes clear that preservation of a previous reconverting bank’s endorsement or (identification, if the reconverting is the paying bank) set off by asterisks on the back of the check also satisfies the requirement of preserving the previous reconverting bank’s identifications.

Warranties

The Act establishes that each financial institution that either creates or transfers a substitute check provides subsequent recipients, such as financial institutions or check writers, with a warranty and an indemnification. The warranty and indemnification provide recipients with protection from any losses arising from the receipt of a substitute check instead of the original check. The rule clarifies that a bank makes the warranties when it transfers, presents, or returns for consideration, the substitute check or any paper or electronic representation of a substitute check. The Board specifically requests comment on whether using information from a check to create an ACH debit entry should be a payment request covered by this warranty. The proposed commentary clarifies that the reconverting bank is the first bank to provide the substitute check warranties.

The proposed commentary clarifies that the reconverting bank is the first bank to provide the substitute check warranties. That discussion also notes that, when a bank is a reconverting bank because by agreement it receives a substitute check that a nonblank created, the reconverting bank starts the warranty chain for that substitute check even if the reconverting bank transfers an electronic representation of that substitute check

instead of the actual substitute check that it received. The proposed commentary also clarifies that a bank that by agreement transfers an electronic version of an original check prior to the creation of the first substitute check does not make the substitute check warranties, but that parties to the agreement can allocate amongst themselves liabilities associated with the substitute check.

Indemnifications

The proposed commentary regarding the scope of the indemnity highlights that the indemnity applies only if the first indemnified party incurred a loss due to receipt of the substitute check instead of the original check. However, a bank that paid an indemnity other than the first reconverting bank, would in turn be eligible to make an indemnity claim even if that bank only received a representation of a substitute check.

A breach of a warranty can result in a warranting financial institution being liable to the recipient for damages, including consequential damages and attorney fees. The rule, supplements the statutory language by specifically stating that interest would be included in the damages proximately caused by a breach of a substitute check warranty. The Act includes two substitute check warranties that: 1) the substitute check meets all the requirements for legal equivalence; and 2) the usage of a substitute check will not cause an entity to pay twice for the same item. If there is not a breach of warranty, then a financial institution may be liable to a recipient for any loss up to the amount of the check and interest and expenses, including attorney fees.

The Act and rule includes a comparative negligence provision. Specifically, when the negligence or failure of the indemnified party contributes to a loss, then the damages that that party can recover from others will be reduced. The indemnified parties will suffer a reduction in their recovery in proportion to the amount of their negligence.

According to the Act and rule, an indemnifying financial institution may limit the amount of damages that it owes to the indemnified party by producing the original check or a copy of it that is accurate and sufficient to prove the validity of the claim. If the indemnified bank produces the original or such a copy, then it is only liable for the losses incurred up to that time and it has a right to reclaim any damages paid by it that exceed that amount of loss. The production of the original or a copy does not absolve the bank from any liability on a warranty established under Check 21 or other laws.

Consumer Protections

The Act provides protections to consumers, but not businesses, who receive substitute checks. These provisions affect credit unions in different ways depending on the way in which they process share drafts. For those credit unions that return share drafts to their members, Check 21 provides special expedited recredit protections to all the credit union's members. For those credit unions that **do not** return share drafts to their members, the special expedited recredit protections will only apply to a member who deposits the check of a third party, if that check bounces and is returned in the form of a substitute check to the member. It may also cover members who request a copy of their share draft and receive a substitute check.

A consumer may make a claim for an expedited recredit before the end of the 40-day period that begins on the later of:

- the date the financial institution mails or delivers the relevant periodic statement; or
- The date the substitute check is made available to the consumer.

The rule clarifies that this is 40 calendar days and that a bank makes a substitute check available by mailing or delivering it to the consumer. This period may be extended for a reasonable amount of time on account of travel or illness, such as an extended hospital stay.

In order to make such a claim, the consumer must assert in good faith that

- The financial institution charged the consumer's account for a substitute check that was provided to the consumer;
- That this check was not properly charged to the consumer's account; or the consumer has a warranty claim;
- The consumer suffered a resulting loss; and
- The production of the original or a better copy (the rule uses the defined term sufficient copy) of the original check is necessary to determine the validity of any claim.

The consumer must make a description of this claim to the financial institution that includes all of the assertions above and sufficient information to identify the substitute check and process the claim. The rule clarifies that a claim that does not include all the required information does not constitute a claim for purposes of Check 21. The rule clarifies that a consumer who receives only an image statement that contains an image of a substitute check cannot make a claim because he or she has not actually received a substitute check, although such a consumer would have redress for an improper charge associated with the substitute check under the UCC and might have a claim for breach of a substitute check warranty. The financial institution may require that the claim be in writing or electronic, if the consumer has agreed to communicate with the bank in that manner. The rule clarifies that if the consumer communicates electronically that is evidence of his or her assent. However, a bank cannot require a consumer to submit a written claim electronically.

The financial institution must recredit a consumer account if the consumer submits a valid claim that meets the requirements above and the financial institution does not turn over a check. If the consumer alleges that a substitute check was improperly charged against the consumer's account, the financial institution must investigate and either (i) resolve the consumer's claim within 10 business days after the claim is made, or (ii) provide the consumer with a recredit for the amount of the substitute check, up to \$2,500, pending completion of the financial institution's investigation. In any case, the financial institution must complete the investigation and make a final determination of the consumer's claim within 45 days at which point any valid recredit claim funds must be recredited. A bank that provides a recredit to a consumer account shall make the recredited funds available for withdrawal by the consumer by the start of the next business day after the banking day on which the bank recredits the consumer's account. If a bank recredits a consumer account, then the bank shall send to the consumer a notice that includes the amount of the recredit and the date the recredited funds will be available for withdrawal. Providing this recredit does not absolve the banks from liability for a

claim made under any other law, under the UCC or Check 21. The Board provides a model notice. A model disclosure for this notice is not required by Check 21 and does not have a safe harbor; thus, the Board specifically requests comment on whether providing model language for this notice is useful.

The rule also clarifies that a bank that requires the consumer's claim to be in writing must compute the time period for acting on the claim from the date that the consumer submitted the written claim, even if the consumer previously provided some information relating to the claim in another form. In addition, the statute measures time from the "business day," which is any day that does not fall on a weekend or legal holiday. The Board proposes to incorporate the term "banking day" as it has for other part of Regulation CC. Banking day means "that part of any business day on which an office of a bank is open to the public for doing substantially all of its banking function." The Board believes that "banking day" is an appropriate term when referring to the time a bank starts its deadlines running. The Board request comment on both of these adjustments relating to time period calculations.

A bank may delay the release of funds in the following cases: for new accounts; account with repeated overdrafts; and accounts suspected of fraud. This delay can last until the 45th calendar day or the business day after the banking day on which the bank makes the determination. The proposed rule clarifies that the availabilities specified above are maximums. A bank that delays the release of funds cannot charge overdraft fees to the consumer on the recredited amount until five days after the bank has sent notice of the delay to the consumer.

If the financial institution determines during the investigation that the account was properly charged, the financial institution may reverse the recredit. If it reverses, then the financial institution must provide the consumer with the original check or a copy of the original check (such as an image copy or another substitute check) and an explanation that the substitute check was properly charged to the account. This explanation must include a statement that the consumer may request copies of any information or documents on which the bank relied in making the determination. In addition, the bank must provide notice of the amount of the reversal and the date that the recredit was reversed. This notice must be provided no later than the business day following the banking day on which the bank reverses the recredit. The Board provides a model notice. A model disclosure for this notice is not required by Check 21 and does not have a safe harbor; thus, the Board specifically requests comment on whether providing model language for this notice is useful.

In the proposal, the Board clarifies that a bank may reverse the interest paid on the recredit, although the statute did not specifically address this. The Board requests comments on this approach. The commentary also clarifies that a bank may, when appropriate, reverse any amount that it previously recredited, regardless of whether such amount originally was provided after a determination that a claim was valid or pending the bank's investigation. The Board requests comment on whether additional commentary would be useful and, if so, what specific points should be covered.

Expedited Recredit Procedures for Financial Institutions

If a substitute check was improperly charged to a consumer's account, then the paying credit union can collect from the presenting financial institution or other indemnifying financial institutions, under special procedures in the Act. The paying credit union or another indemnified credit union can collect so long as it

- or a bank that it indemnified received a claim for expedited recredit from a consumer;
- the claim bank suffered a resulting loss or is obligated to repay the consumer; and
- the production of the original or a better copy is necessary to prove the claim.

The credit union has 120 days from the date of the transaction to seek an expedited recredit, and the credit union must send to the indemnifying institution

- a description of the claim and why it is not properly chargeable to the account;
- a statement that the claimant financial institution has suffered a resulting loss or is obligated to recredit a consumer account;
- the reason why production of the original share draft or a sufficient copy is necessary; and
- information sufficient for the indemnifying bank to identify the substitute check for which any such claim is made.

An indemnifying bank may, in the discretion of the bank, require the claimant bank to submit this information in writing. It may also permit the claimant bank to submit the information electronically.

The commentary highlights that a bank could have a recredit claim either because it is obligated to provide a recredit to a consumer or another bank or because it has suffered a loss as result of catching a substitute check problem that, if uncaught, could have given rise to a consumer expedited recredit claim. The commentary provides examples about the types of losses that could give rise to consumer claim and the circumstances under which a bank could bring a valid claim.

The indemnifying financial institution within 10 days must take one of three actions: 1) provide the original or a suitable image; 2) recredit the claimant financial institution for the amount of the claim up to the amount of the substitute check; or 3) explain why a recredit is not warranted. Under the rule, the 10 days begin with the receipt of the written claim. The recredit does not absolve the indemnifying institution of other liabilities under the Act. If a claimant bank reverses a consumer recredit, then the claimant bank shall promptly refund to any indemnifying bank, any amount previously advanced by the indemnifying bank in connection with such substitute check. Moreover, production of the original by an indemnifying bank may limit its losses in the same way that doing so would limit its losses in the case of consumer recredits. An indemnifying bank that provides an original check or sufficient copy also may be entitled to a refund if it has provided a recredit that exceeds the losses of the claimant bank up to that point. This is the only section of the Act that may be modified by an agreement among financial institutions.

Delays In an Emergency

If the bank fails to meet the time limits in this Act, such failure shall be excused for emergencies outside of the control of the bank.

Measure of Damages

Other entities besides financial institutions that breach a warranty or fail to comply with the Act shall be liable to such persons for the lesser of the amount of the loss suffered by the other person; or the amount of the substitute check; and the interest and expenses related to the substitute check.

Statute of Limitations and Notice of Claim

A claim under the Act may be enforced in court before the end of the 1-year period beginning on the date the cause of action begins. The beginning of such an action starts on the date that the injured party first learns, or by which such person reasonably should have learned, of the cause of action. If a consumer files a claim within the time limits of the act, then this is considered timely. If a person, and entity or corporation does not submit a claim within 30 calendar days after the person has reason to know of the claim and the identity of the indemnifying bank, the indemnifying or warranting bank is discharged from liability in an action to enforce a claim under this Act for losses caused by the delay.

Public Education

Credit unions must provide a consumer awareness notice to their members who may receive substitute checks in their account statements. The Board believes that disclosures are intended only for (1) consumers who routinely receive paid checks with their account statements and (2) other consumers who receive substitute check only on a case-by-case basis. The proposed rule reflects this interpretation. The proposed rule notes that, unless the bank already has provided the disclosure, a case-by-case disclosure is required when (1) a consumer receives a substitute check in response to his or her specific request for an original check or a copy of a check or (2) a check deposited by a consumer is returned unpaid to the consumer's account in the form of a substitute check. 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 disclosures at the time the bank provides the substitute check to the consumer. The Board specifically requests comment on which of these alternatives is preferable.

The proposed regulation includes the model disclosure.

Credit unions must provide a brief notice about substitute checks that describes

- How a substitute check is the legal equivalent of an original check for legal purposes if it
 - accurately represents the information on the front and back of the original
 - and bears the appropriate legend.
- The consumer recredit rights under Check 21.

Credit unions must provide these notices to new consumers who will receive share drafts on the date their account is opened and to existing consumers no later than the first regularly scheduled communication with the consumer after October 28, 2004. These notices may be sent by mail or through other means that the consumer has agreed to. These notices must also be provided to consumers who request copies of checks and receive a substitute check, at the time of the request.

The Federal Reserve is required under the Act to prepare a model notice by July 28, 2004, that financial institutions may use for public education, but financial institutions are not required to use the model disclosure. Those financial institutions that use the model notice, however, will be presumed to be compliant with the Act if the model form accurately describes the financial institution's policies and practices. The regulation includes proposed disclosures and examples of when a bank must distribute the required disclosure. The Board requests comments on whether the disclosure is clear.

Effect on Other Law

This Act shall supersede any provision of law that is inconsistent with this Act, but only to the extent of the inconsistency. According to the rule, a law is not inconsistent with Check 21 merely because it allows for the recovery of additional damages.

Regulatory Authority of Federal Reserve

The Federal Reserve has been given the authority to promulgate regulations under the Act, and it intends to do so. The Federal Reserve is also required to evaluate how Check 21 affects funds availability and to provide a report to Congress within 30 months of October 28, 2004. This report shall include the results of the study and recommendations for legislative action.

The Act requires the Federal Reserve to disclose in its annual report for the next ten years, the amount of operating costs attributable to, and an estimate of the Federal Reserve financial institutions' imputed revenues derived from, the transportation of commercial checks between Federal Reserve financial institution check processing centers.

Miscellaneous Regulation CC Provisions

The Board also is proposing, at this time, several amendments to existing Regulation CC and its commentary that are unrelated to the Check 21 Act. The Board requests comment on each of these proposed revisions and also welcomes comments about any other areas of the existing rule and commentary that should be clarified.

The Board proposes to amend the commentary to the definition of local paying bank to provide additional detail regarding how to determine whether deposits mailed to a central check processing facility are local or nonlocal.

The Board proposes adding a sentence to the commentary to clarify that a special deposit slip notice need not be posted at each teller window, although it must be posted in a place where consumers are likely to see it before making a deposit.

The Board proposes to amend the commentary regarding notices of exception holds to clarify that a bank providing such a notice electronically to a consumer must comply with the requirements of the Electronic Signatures in Global and National Commerce Act (E-Sign Act).

The Board tends to clarify that general notices must comply with the E-Sign Act; be “clear and conspicuous,” and the condition for when they can be in a foreign language.

The Board proposes amending the process to extend the deadline of a return or notice of nonpayment under the UCC or Regulation J. The current paragraph allows extensions when a paying bank uses a means of delivery that ordinarily would result in receipt by the receiving bank’s next banking day. At least one court has interpreted the current provision to permit an extension of the midnight deadline even when the check was received by a returning bank at a time that was too late for the returning bank to process the check that day. The proposed rule would therefore, more specifically, describe the applicable time of receipt to the bank’s cutoff hour for the next processing cycle (if sent to a returning bank) or next banking day (if sent to a depository bank). This is similar to the existing language in the regulation. The Board proposes corresponding changes to the commentary to this section.

The Board proposes to allow financial institutions that are unsure of indorsement information to set it off with asterisks and other applicable methods, instead of limiting them only to question marks.

The Board also proposes amending the rule to state that a bank must send or give the consumer notice regarding receipt of a returned check or notice of nonpayment. This clarifies that the notice does not have to be in writing.

The Board request comments on whether it makes sense to incorporate a recent UCC revision. The UCC revision defines a remotely-created consumer item to mean “ an item drawn on a consumer account, which is not created by the payor bank and does not bear a handwritten signature purporting to be the signature of the drawer.” The UCC revision would allow a paying bank to use a warranty claim to absolve itself of responsibility for honoring this type of item if a drawer claims it is unauthorized.

QUESTIONS REGARDING THE PROPOSAL

1. The statute measures time from the “business day” a day other than a weekend or legal holiday. The Board propose to incorporate the term “banking day” as it has for other party of Regulation CC. Banking day means “that part of any business day on which an office of a bank is open to the public for caring on substantially all of its banking function.” The Board believes that “banking day” is an appropriate term when referring to the time limits for a bank to provide a recredit and make funds available for a recredit. The Board requests comment on both of these adjustments relating to time period calculations. Does your credit union support these adjustments?

2. The Board provides sample notices for notifying consumers in the following situations: that their claim is valid; their claim is not valid; their account has been recredited; and their recredit has been reversed. Check 21 requires that a financial institution provide these notices, but does not require the Federal Reserve to provide sample notices. In addition, Check 21 does not provide safe harbor for these notices. Should the Federal Reserve include these sample notices in its appendix? Please explain if all samples should be kept or if only certain ones should be kept.

3. The proposed rule notes that, unless the bank already has provided the disclosure, a case-by-case disclosure is required when (1) a consumer receives a substitute check in response to his or her specific request for an original check or a copy of a check or (2) a check deposited by a consumer is returned unpaid to the consumer's account in the form of a substitute check. 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 disclosures at the time the bank provides the substitute check to the consumer. The Board specifically requests comment on which of these alternatives is preferable.

4. Is the Check 21 required consumer awareness notice regarding substitute checks clear and conspicuous? Does your credit union recommend any changes? Please explain.

5. In the proposal, the Board clarifies that a bank may reverse the interest paid in the recredit, as well, although the statute did not specifically address this. The Board requests comments on this approach. The commentary also clarifies that a bank may, when appropriate, reverse any amount that it previously recredited, regardless of whether such amount originally was provided after a determination that a claim was valid or pending the bank's investigation. The Board requests comment on whether additional commentary would be useful and, if so, what specific points should be covered.

6. The Board notes that Check 21 and the proposed rule state that the warranty against duplicative presentment or return applies such that a person will not be asked to make a payment based on a check it already has paid. This language could be read to exclude a situation where a second charge results from an ACH debit that was created

using information from an original check or substitute check. Such as ACH debit could be considered an electronic version of a substitute. The Board specifically requests comment on whether using information from a check to create an ACH debit entry should be a payment request covered by this warranty. Please comment.

7. However, the proposed rule provides that the recipient of an item that purports to be but is not a substitute check (e.g., a substitute check with the wrong amount in the MICR line) has warranty and indemnity rights, and, where applicable, recredit and consumer awareness disclosure rights under subpart D as though the item were a substitute check. The Board requests comments on whether an item that fails to meet any of the other substitute check requirements also should be treated as though it were a substitute check for those limited purposes.

8. The Board requests comment on all aspects of the proposed indorsement and identification standards discussed above.

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9. 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.

10. The commentary also clarifies that a bank may, when appropriate, reverse any amount that it previously recredited, regardless of whether such amount originally was provided after a determination that a claim was valid or pending the bank's investigation of the claim. The Board requests comment on whether additional commentary would be useful and, if so, what specific points should be covered.

11. The Board asks for comment on the miscellaneous changes to Regulation CC and any other part of Regulation CC.

12. The Board also requests comments on whether there are circumstances under which it would be appropriate to reduce the time frame for providing a notice of nonpayment.

13. Do you agree that the commentary adequately describes the interaction of Check 21 with other check law, such as the UCC? Please explain where more clarification is needed.

14. The Board request comments on whether it makes sense to incorporate a UCC revision. The UCC revision defines a remotely-created consumer item to mean “ an item drawn on a consumer account, which is not created by the payor bank and does not bear a handwritten signature purporting to be the signature of the drawer.” The UCC revision would allow a paying bank to use a warranty claim to absolve itself of responsibility for honoring this type of item if a drawer claims it is unauthorized. This revision rests on the premise that monitoring by depository banks can control this type of fraud more effectively than any practices readily available to paying banks.

15. Do you agree with the Board’s usage of industry standards?

Please submit your address and phone number.

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