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October 21, 2003

Mr. Stephen M. Vajs  
Director, Risk Management Division  
Financial Management Service  
U.S. Department of the Treasury  
Room 423  
401 14<sup>th</sup> Street, S.W.  
Washington, DC 20227

Re: Department of the Treasury, Fiscal Service; Federal Government Participation in the Automated Clearing House; 31 CFR Part 210; 68 Federal Register 50672, August 21, 2003.

Dear Mr. Vajs:

The American Bankers Association ("ABA") appreciates the opportunity to comment on the Department of the Treasury's ("Treasury") proposed regulation modifying the regulation governing the use of the Automated Clearing House ("ACH") system by Federal agencies ("agencies"). The American Bankers Association brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership - - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - - makes ABA the largest banking trade association in the country.

#### **BACKGROUND**

In part, this proposed regulation addresses issues arising from the conversion to ACH debit entries of checks presented to the agencies. Since the April 2002 issuance of a final rule permitting agencies to make such a conversion, Treasury has initiated various procedures to encourage check conversions. According to Treasury, the cost-savings and efficiencies to the Federal government through the check conversion process currently are not fully obtainable because of certain impediments that Treasury hopes to remove through this proposed regulation.

The Treasury believes its proposed regulation would achieve these objectives by reducing the detail of the current disclosure provided the check writer, by authorizing accounts receivable check conversion rules rather than the point-of-purchase ("POP") rules in situations where the ability to comply with the POP rules is impracticable, by eliminating the regulatory prohibition against conversion of payment instruments such as money orders, traveler's checks, certified bank checks and credit card checks and by authorizing "agencies to originate an ACH debit entry

in order to collect a service fee related to an (sic) Re-presented check ("RCK") entry if notice of the fee is given to the Receiver before the agency accepts the Receiver's check."

In addition, the proposed regulation modifies certain aspects of the Federal government's process of reclaiming Federal benefit payments and misdirected Federal payments. According to Treasury, the proposed regulation would:

- "(1) require financial institutions that learn that an account holder has died to return any subsequent Federal benefit payments using return reason code R15 (Beneficiary or Account Holder Deceased) or R14 (Representative Payee Deceased), as appropriate;
- (2) provide that financial institutions are not liable for post-death benefit payments to which the recipient was entitled;
- (3) require a financial institution that becomes aware that a Federal benefit payment was misdirected to notify the agency that sent the payment of the error;
- (4) prohibit agencies from reclaiming payments that were made more than seven years prior to the date of the notice of reclamation;
- (5) limit the information that agencies may request from financial institutions, in accordance with the Right to Financial Privacy Act; and
- (6) allow financial institutions to notify an account owner of the receipt of a notice of reclamation 'promptly' rather than 'immediately'."

## **ABA POSITION**

### **General**

While the ABA recognizes the value of the periodic review of the check conversion and reclamation procedures for agencies and supports such activity by Treasury, the ABA urges Treasury to delay further consideration of the check conversion procedure modifications at this time and, in any case, revise certain aspects of the proposed regulation so as not to impose additional regulatory burdens on financial institutions. In the case of proposed reclamation procedure modifications, the ABA commends Treasury for its effort in this area and includes a specific suggestion for additional improvement. The following discussion will amplify ABA's overall position.

There is no question but that the President's impending signature on the House and Senate Conference Report for H.R. 1474, the "Check Clearing for the 21<sup>st</sup> Century Act" ("Clearing Act") will herald a new efficiency, cost reduction and consumer benefit in check processing. It is anticipated that

the Federal Reserve Board's regulations implementing the above law will be proposed and finalized by early 2004. This new opportunity for earlier truncation presented the banking industry will demand the attention and resources of banks throughout the country along with an extensive educational program for consumers in order to achieve the objectives of this new law. This will cause consumers to adjust the manner in which they handle their accounts and their understanding of the truncation process.

In the light of these significant changes, the ABA urges Treasury not to proceed with its proposed modifications to the check conversion process at this time. Treasury's imposition of changes to the check conversion process for Federal agencies at the same time as the implementation of the Clearing Act will tax the banking industry's resources and result in additional consumer and banking industry inquires, disputes and confusion. Also, Treasury will likely accomplish some of its objectives contained in this proposed regulation through the overall implementation of the Clearing Act,

In addition, the ABA urges Treasury to ensure, whenever possible, the consistency of the relationship between the ACH system and this proposed regulation. Whenever Treasury departs from the National Automated Clearing House ("NACHA") Operating Rules ("Rules") governing the ACH system, the end result is an increased regulatory burden on the banking industry, especially for the paying bank. Such a departure will create exceptions to the normal processing of ACH items. These exceptions will generate additional customer service inquiries, customer complaints and returned items. The banking industry would have to make significant system modifications to adequately respond to many of the modifications proposed by Treasury.

For example, as the ACH payment system has moved to more converted checks based on a one time authorization, the impact on the Receiving Depository Financial Institution ("RDFI") must always be taken into account in adopting any modifications to the check conversion process. Importantly, the RDFIs should have consistent rules on which to base their operating processes and thus minimize the number of exceptions. Generating additional exceptions creates additional expenses for RDFIs in the handling and processing of these exceptions.

In particular, departure from the NACHA Rules for Federal agency electronic check conversion payments will require RDFIs to bear costs associated with a greater volume of exception items, to engage in legal disputes over appropriate authorization, to make systems changes to recognize and outsort Federal agency conversion entries for special handling, and to encounter customer service inquiries, complaints and dispute resolution. Throughout the process, Treasury provides no compensation to reimburse the RDFIs for their additional costs while the economic benefit is exclusively reserved for the agencies.

Over the years, the Federal government and the RDFIs have both benefited from the consistency between the Federal government's and NACHA's

Rules governing participation in the ACH. This common approach to ACH processing for both government and commercial ACH transactions has resulted in cost savings and reduced regulatory burden for both the government and the private sector. These benefits should underlie the Treasury's approach to modifying the Federal government's participation in the ACH system.

While recognizing ABA's overall objections to the finalization of the Treasury's proposed regulation relating to check conversion, ABA suggests various modifications to the proposal should Treasury decide to finalize this aspect of the proposed regulation. These specific recommendations are discussed below.

### Check Conversion

#### Revised Accounts Receivable Disclosure

The ABA questions the timing of Treasury's proposed shortening of the disclosure language for government Accounts Receivable ("ARC") entries required of Federal agencies in Appendix C of the current regulation. Until such time as check conversion through the ACH Network is a more widely understood process by consumers, full disclosure is best. With the advent of the Clearing Act becoming law, the entire payments industry must be very diligent not to add unnecessarily to consumer confusion.

#### Expanded Accounts Receivable Check Conversion Applications

Treasury indicates that there are numerous activities where a Federal agency receives a check for payment or to cash (e.g., military payroll checks), but is not in a position to scan the check at the site of acceptance to initiate a Point-of-Purchase ("POP") as currently defined in the NACHA Rules. Therefore, Treasury proposes to allow for the conversion of consumer checks to ARC entries, and business checks to Cash Concentration or Disbursement ("CCD") entries in these situations. The physical check would be destroyed rather than returned to the check writer.

The ABA understands the nature of these activities and believes that the conversion of consumer checks to ARC would not cause significant confusion on the part of the consumer if:

- a. The consumer is given fuller disclosure of what actions will occur prior to the transaction taking place.
- b. Only US Treasury checks are converted to CCD.
- c. No business checks under any definition are converted.
- d. This process is limited to locations where it is truly impossible to process the items as a POP.

## Conversion of Additional Instruments

Treasury proposes to revise the definition of a "Business Check" that may serve as an acceptable source document for a Federal agency-originated ARC or POP entry to include:

- a. A check drawn on a corporate or business deposit account, including a third-party check,
- b. A credit card check,
- c. A negotiable instrument issued by a financial institution (e.g., a traveler's check, cashier's check, official check, money order, etc.) and
- d. A check drawn on a state or local government.

Such a change in the business check definition is a clear departure from the NACHA Rules and would be a significant regulatory burden on RDFIs. If adopted, RDFIs will have to expend millions of dollars industry-wide to modify systems that could identify Federal agency-initiated, check converted ACH entries drawn on business accounts so that a prompt and proper review for authorization could be conducted (within 24 hours for business transactions vs. 60 days for consumer transactions). Further, RDFIs may not be able to post the business ACH entries because the account may have a debit block or filter on the account that does not allow electronic debits. This would create an exception for the RFDI and additional cost to Treasury and the Federal agencies because a paper draft would have to be created to collect the funds. Cashier's check, official check, and money order systems normally have electronic debit blocks that would generate returns to the Federal agencies. In many cases a paper draft would also be returned. This would cause a very expensive operational problem for both Treasury and the RFDI.

In addition, there are several legal issues posed by such a definitional change. The individual or business presenting the check for payment does not have the legal authority from the issuing party that owns the account to authorize the conversion of the item. Issuers of some classes of items such as money orders will have difficulty proving compliance with state legal requirements that customers receive certain information (e.g., concerning payment of fees, expiration of money orders, etc.) without the original item or a full image of the original item. Also, credit card checks are draws on lines of credit and, thus, are loan documents. These items are handled very differently from checks at many banks. The conversion of credit card checks would cause special legal and operational problems for RDFIs.

### Re-Presented Check Entry Service Fees

Currently, the ACH Rules prohibit the imposition of a service fee to an RCK entry. Treasury proposes to "allow agencies to originate an ACH debit entry in order to collect a service fee related to an RCK entry . . . ."

While the ABA believes that the ACH system should be used for the collection of a service fee for RCK entries, NACHA Rules do not allow for this and there is no Standard Entry Code for this service. Thus, until NACHA modifies its Rules to authorize the collection of a fee in this instance, ABA opposes Treasury's proposal that would allow agencies to originate this type of transaction.

### Reclamations; Misdirected Payments

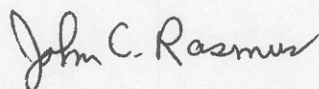
The ABA commends Treasury in its effort to bring clarity and simplification to the current regulation through its proposed modifications to the reclamation and misdirected payments component of the current rules. However, there are conditions under which an RDFI's automated system will return an R02 when Treasury might expect an R14 or R15. If the executor has closed the account then an R02 would be generated before the RDFI's ACH staff can review the transaction. Any final regulation in this area by Treasury should recognize and accommodate this situation.

### CONCLUSION

The ABA urges Treasury not to proceed with its proposed modifications to its check conversion regulation at this time. In the context of the implementation of the Clearing Act, such modification will impose significant burdens on the banking industry and on consumers. Also, ABA urges Treasury to ensure consistency between the ACH system and the agencies' participation in this system. In addition, the ABA recommends specific changes to the proposed regulation in the area of check conversions and reclamations while recognizing Treasury's efforts to bring clarity and simplification to the reclamation process.

If you have any questions or need additional information regarding this letter, please do not hesitate to contact Stephen Schutze, Director, eStrategies at 202-663-5353 or the undersigned at 202-663-5333.

Sincerely,



John C. Rasmus