

VIA E-MAIL

October 20, 2003

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

**Re: 31 CFR Part 210 -- Government Participation in the Automated  
Clearing House ("ACH") Network**

Dear Mr. Vajs:

NACHA<sup>1</sup> welcomes this opportunity to comment on the notice of proposed rulemaking ("NPRM") issued by the Treasury Department's Financial Management Service ("FMS") regarding proposed changes for Federal agency payments that differ from what is currently permitted by the NACHA Operating Rules ("NACHA Rules") for electronic check conversion and other changes. Attached are NACHA's detailed comments with respect to the relevant proposed changes in the NPRM.

FMS and NACHA have a long history of promoting electronic payment methods. NACHA recognizes that FMS' intent with this NPRM is to further promote electronic collection alternatives. However, we are deeply concerned about significant divergence from the NACHA Rules. This divergence began with the changes to 31 CFR Part 210 adopted in April 2002 allowing conversion of business checks for Federal agency payments. The proposed changes in this NPRM represent further substantial diversion from what is permitted by the NACHA Rules.

The U.S. Government is the single largest ACH Originator, and as such its rules apply to a significant portion of total ACH volume. The consistency between 31 CFR Part 210 and the NACHA Rules that has been in place for several years has served both the Federal government and the private sector well through cost savings and reduced regulatory burden due to the common approach to ACH processing for both government and commercial ACH transactions.

Therefore, we strongly oppose several of FMS' proposed changes to electronic check conversion policies.

---

<sup>1</sup> **About NACHA—The Electronic Payments Association:** NACHA is the leading organization in developing electronic solutions to improve the payments system. NACHA represents more than 12,000 financial institutions through direct memberships and a network of regional payments associations, and over 650 organizations through its industry councils. NACHA develops operating rules and business practices for the ACH Network and for electronic payments in the areas of Internet commerce, electronic bill payment and presentment (EBPP), financial electronic data interchange (EDI), international payments, electronic checks, and electronic benefits transfer (EBT). Visit NACHA on the Internet at: [www.nacha.org](http://www.nacha.org).

Specifically, the inconsistencies with the NACHA Rules inherent to FMS' proposed changes would:

- Substantially increase costs to the private sector and the regulatory burden associated with processing Federal agency payments;
- Sow confusion among consumers and businesses as Federal agency customers or beneficiaries; and,
- Undermine financial institution and other financial services provider services and customer agreements.

**Increased Costs and Regulatory Burden:** Divergence from the NACHA Rules for Federal agency electronic check conversion payments will require financial institutions and other issuers of checks that would be converted to bear costs associated with greater volume of exception items, legal disputes over appropriate authorization, systems changes to recognize and outsort Federal agency conversion entries for special handling, and customer service inquiries, complaints and dispute resolution.

Moreover, contrary to FMS' assessment in the NPRM, NACHA believes FMS' proposed changes *do* represent a "significant regulatory action," given the likely impact on consumers, businesses and financial institutions. For example, financial institutions will have to expend millions of dollars industry-wide to employ systems that could identify Federal agency-initiated ACH entries drawn on business accounts so that a prompt and proper review for authorization could be conducted. Further, financial institutions, businesses and government agencies that issue checks to third-parties that could be used as payment to Federal agencies (e.g., official checks, cashier's checks, credit card convenience checks, money market mutual fund checks, money orders, state warrants, etc.) would have to employ complex verification systems to ensure that such checks were (1) legally authorized for conversion by the check issuer and (2) were properly payable (i.e., not forged, counterfeit, or altered).

Estimates of the total costs to accommodate converted business check entries through bank and credit union systems vary, but the expense of the software and integration alone could be in excess of \$100,000,000 if Federal agency converted business check volume increases to the point where financial institutions can no longer handle the entries through an exception process. For converted entries drawn on third party check issuers, as proposed, these costs could be even more substantial. We also do not believe that FMS has adequately thought through the costs, both to the Federal government and to the private sector, associated with potentially significant volumes of returned ACH entries having to be processed and replaced with demand drafts, which may also be returned for lack of appropriate authorization. Finally, it is likely under the scenario envisioned by FMS that individuals and businesses will frequently incur late payment fees or penalties, simply because the check conversion entry had to be returned (and, possibly, the resultant demand draft also returned) in today's operational and legal environment.

NACHA expects the sum total of these costs will be significant to financial institutions, to businesses and to consumers, and we do not believe this is reflected in the NPRM through a proper regulatory impact analysis. Nor does NACHA share FMS' optimism when it comes to federalism issues, as there may also be a direct impact on the States whose laws generally govern check negotiability and collection. States will also be impacted as senders and receivers of Federal agency payments, as issuers of state warrants, and as lawful regulators of various forms of check use, such as money orders issued by money services businesses.

**Marketplace Confusion:** Check conversion (e.g., through the ACH Network) and check truncation (e.g., as supported by the *Check Clearing for the 21<sup>st</sup> Century Act*, or "Check21") are relatively new and still evolving payment applications. While both approaches to the reduction in physical check collection are very promising, consumers and businesses have not yet necessarily adapted to these processes, or fully recognize their associated legal rights and responsibilities when a check is converted or truncated. FMS' adopting divergent approaches to the types of checks eligible for conversion to ACH entries, the authorization procedures associated with each application, and its reliance on the Receiver's financial institution to sort it out is a recipe for confusion, disputes,



and payment uncertainty.

NACHA (as well as FMS and other agencies for that matter) have worked long and hard to build a consistent approach to electronic check conversion with clear benefits to consumers, businesses and financial institutions. The changes proposed in the NPRM, if adopted, would only cloud the matter and lead payments system users to question the benefits associated with conversion. Further, check collection processes that would be supported under Check21, when implemented next year, offer many of the same benefits that FMS is seeking through this NPRM, and all types of checks are eligible for truncation under the Act. NACHA would encourage FMS to refrain from adopting the check conversion proposals in this NPRM and look instead to harnessing the benefits of truncation under Check21 to the Federal government's advantage.

**Position of Financial Institutions:** Adoption of the proposed check conversion changes to 31 CFR Part 210 would compromise many of the services financial institutions and other businesses provide to their customers. In some respects, it could also place an institution or business in an adversarial relationship with its customer, solely due to the Federal government's different policies governing ACH payments. For example, converting a check that was issued by a financial institution or business to a third party could directly conflict with account agreements (i.e., between the financial institution the check is drawn on and the issuer of the check), various state laws governing check negotiability, and the operational capabilities supporting corporate treasury services. At a minimum, the issuing party and the financial institution will be called upon to explain why payment was either not made, or conversely, why payment was made without the issuer's authorization.

\* \* \* \* \*

NACHA and its member payment associations and financial institutions are committed to working closely with FMS and other federal agencies to expand the opportunities offered by electronic check conversion of checks for Federal agency payments. We understand that FMS is open to an ongoing dialogue with NACHA and the industry in this regard and welcome the opportunity to supplement our comments. After further review, through additional correspondence and meetings with appropriate FMS staff, NACHA is willing to explore with FMS how it can continue to reduce hurdles to electronic conversion through a consistent and coordinated approach. To arrange such a meeting, or if you have any questions regarding NACHA's comments, please do not hesitate to contact me by e-mail at: [imacoy@nacha.org](mailto:imacoy@nacha.org), or by telephone at (703) 561-3929.

Sincerely,

Ian W. Macoy  
Senior Director

Attachment: NACHA Comments on 31 CFR Part 210 Proposed Changes

cc:

Richard L. Gregg, Commissioner, FMS  
Donald V. Hammond, Under Secretary for Domestic Finance, U.S. Department of the Treasury  
Richard Oliver, Senior Vice President, Federal Reserve Bank of Atlanta  
John Galligan, Program Advisor, FMS  
Natalie Diana, Senior Counsel, FMS

**NACHA COMMENTS ON 31 CFR PART 210**  
**October 20, 2003**

**A. Check Conversion**

The 2002 changes to 31 CFR Part 210 allow Federal agencies that receive consumer or business checks at a point-of purchase location ("POP" entries), or via the mail or at a dropbox ("ARC" entries), to convert those checks to debit ACH entries if certain standard notice is provided by the agency. In contrast, the NACHA Rules do not allow for the conversion of checks drawn on business accounts for these applications due to operational and other difficulties associated with the processing of such transactions by financial institutions serving business customers with various types of loss-prevention/treasury management services.

**A.1. Revised Accounts Receivable Disclosure**

NACHA questions FMS' proposed shortening of the disclosure language for government ARC entries required of Federal agencies in Appendix C of 31 CFR Part 210. Until such time as check conversion through the ACH Network is a more widely understood process on the part of the consumer base in this country, NACHA would recommend that FMS take a "more is better" approach in terms of government ARC authorization. We believe that consumer education on check conversion is an area where FMS, on behalf of the Federal government, can continue to play a key role by actively reaching out to consumers making payments to Federal agencies. We would encourage FMS to view its agency disclosure language as one cost-effective opportunity to ensure this education is delivered.

**A.2. Expanded Accounts Receivable**

FMS 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 either a POP or ARC as currently defined in the NACHA Rules. FMS therefore proposes to expand its interpretation under 31 CFR Part 210 of what constitutes eligible acceptance of a check for conversion. Specifically, FMS indicates that the nature of several remote check acceptance activities resemble accounts receivable conversion, even if not technically embraced by the NACHA Rules. FMS therefore proposes to allow for the conversion of consumer checks to ARC entries, and business checks to CCD entries, in these situations. The physical check would be destroyed rather than returned to the checkwriter.

NACHA recognizes the unique difficulties faced by Federal agencies in the types of payment scenarios described in the NPRM. We also believe that FMS has endeavored through its proposal to address these difficulties in a logical manner that is largely consistent with the requirements of the current NACHA Rules. However, with respect to business checks being converted to CCD entries, we believe that the problems already associated with business check conversion will be exacerbated and strongly oppose such a move. Moreover, with CCD entries, businesses and their financial institutions will experience significant difficulty identifying these important government entries from among traditional CCD entries. With the short timeframes for returning corporate ACH entries, the Receiving Depository Financial Institution ("RDFI") and the Receiver in these cases may not be in a position to



make a return decision with respect to an entry's authorization in the proscribed timeframe.

### **A.3. Eligibility of Additional Instruments**

The NACHA Rules specifically preclude certain types of checks from eligibility as source documents for ACH conversion applications due to operational difficulties inherent to their processing as ACH debits by the checkwriter's financial institution. Additionally, with several types of these checks, the holder of the check who is seeking to use it to purchase goods or services may not have legal authorization from the issuer of the check to assent to its conversion.

The NPRM 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:

- (1) A check drawn on a corporate or business deposit account, including a third-party check;
- (2) A credit card check;
- (3) A negotiable instrument issued by a financial institution (e.g., a traveler's check, cashier's check, official check, money order, etc.); and
- (4) A check drawn on a state or local government.<sup>2</sup>

As noted throughout our response, NACHA is deeply concerned about the impact this proposed change would have on financial institutions and their customers, and strongly oppose its adoption.

*Converting Business Checks – General Comment:* We believe that converting more classes of business checks will exacerbate the problems associated with the current provision that allows for Federal agency conversion of business checks to ACH debits. Because many financial institutions have different processing streams for checks and for ACH transactions, the RDFI may not be able to post the ACH entry (e.g., the account may have a debit block or filter on the account, or the account number may have incorporated processing information in the form of additional digits that cannot be translated or parsed by the ACH processing system employed). Expansion of business check conversion by Federal agencies will result in significant reliance by the Federal government on demand drafts to collect on entries that cannot be posted to the Receiver's account as ACH entries, and will sour the public's appetite generally for electronic conversion.

At the same time, a check drawn on a business account that provides risk management or treasury management services may clear through the ACH processing system, but not be subject to the screening procedures that these services provide. This can, at a minimum, create account reconciliation problems for the business customer; at worst, it can allow an item that has been altered to be paid when the check processing system would have detected the discrepancy and prevented payment.

*Operational Issues:* As noted, the types of checks FMS proposes to make eligible for conversion are generally drawn on an account not controlled by the individual or company using the check to initiate payment. Therefore, the check issuer (e.g., a financial institution, company, credit card issuer, money

---

<sup>2</sup> Federal Register, August 21, 2003, p. 50677.

order firm, money market mutual fund, etc.) is not in a position to assent to its check's conversion. This is an operational hurdle as well as a legal hurdle. When the RDFI receives the entry for processing and posting, the issuer and possibly the RDFI may dispute the item with respect to its authorization (provided there is sufficient time to review the entry) and return it since, in this case, the issuer was unaware of the item's conversion. Moreover, if FMS then attempts collection via a demand draft, the Receiver may have instructions in place with its financial institution (the RDFI on the original ACH entry) to reject such items as not properly authorized. NACHA expects this will particularly be the case with:

- Money market checks;
- Official, teller and cashier checks--which are often issued in large denominations and processed manually due to their security features;
- Traveler's checks;
- Credit card convenience checks--which represent extensions of credit and are processed as such; and
- Money orders.

*Legal Issues:* Generally, the types of checks FMS envisions as being included for ARC or POP conversion<sup>3</sup> are issued by a third party (e.g., a financial institution, a money order business, a money market, etc.) and therefore are not drawn on an account "owned" by the individual or business seeking to use the check. This poses several legal problems, including:

- The individual or business using 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;
- The "authorization" to convert the check is not provided to the Federal agency by the holder of the account on which the check is drawn;
- The check frequently contains one or more physical security measures (e.g., watermarks, ink types, security threads, etc.) that are circumvented with conversion, and lost with re-creation as a demand draft;
- Compliance with the record retention requirements of 31 CFR 103 Subpart C, Sections 103.33, 103.34 and 103.37 may be hampered with the unavailability of the original monetary instrument (i.e., this may prevent the paying institution from inspecting the paid instrument and the endorsements thereupon for evidence of violation of money laundering prohibitions); and
- 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 the money order, etc.) without the original item or a full image of the original item.

NACHA believes that the sum total of implementing this proposed change would be:

- A significant increase in the number of ACH entries (and demand drafts) returned as Unauthorized -- a costly process to the RDFI and ultimately all ACH participants;
- Heavy reliance by FMS on demand drafts to collect on returned ACH entries, which will also

---

<sup>3</sup> Or for a CCD under the proposed expansion of eligible items for remote lockbox/dropbox conversion.



- either be returned unpaid or will be paid without necessarily the proper authorization in place;
- Friction between RDFIs and their check-issuing customers;
  - Uncollected funds for the Federal government and debtor or late-payment status inappropriately conferred on the paying consumer or business; and,
  - Legitimate questions being raised regarding the legality of such checks being converted.

For these reasons, we strongly encourage FMS to refrain from making these additional classes of checks eligible for conversion to ACH entries under 31 CFR Part 210.

#### **A.4. Re-Presented Check Entry Service Fees.**

FMS is proposing to reduce the authorization requirement for collecting service fees for returned checks that have been represented using the RCK application. Currently, consistent with the NACHA rules, 31 CFR Part 210 requires a Federal agency to obtain from the Receiver explicit authorization for the separate ACH entry used to collect the service fee. FMS is proposing to reduce this authorization to simple disclosure to the Receiver at the point where the original check was accepted for payment.

To date, NACHA has not viewed returned check service fee collection as a unique ACH application (a service fee can be collected using a PPD entry). Consequently, the Receiver's (i.e., original check writer) explicit authorization is required to initiate the entry. NACHA has not pursued the approach contemplated by FMS in the NPRM for service fees for returned checks due to the need to ensure that the consumer is informed and specifically assents to the transaction (see above comments re: ARC disclosure). Therefore, we strongly encourage FMS to continue to require Federal agencies to obtain the consumer's explicit authorization.

### **B. Reclamations**

#### **B.1. Mandatory Use of R15 or R14 Return Reason Codes**

A financial institution is required to return any Federal benefit payment received after the institution learns of the death of the recipient. FMS notes in the NPRM that financial institutions typically return such payments using either an R02 (Account Closed), R15 (Beneficiary or Account Holder Deceased), or R14 (Representative Payee Deceased). FMS proposes to specify that only an R15 or R14 code be used to effect these returns. An institution using an R15 or R14 return reason code satisfies its obligation to notify the Federal agency of the death of the recipient, if the institution had not learned of that death directly from the agency.

While the proposal would seem to offer simplicity and clarity, several members have nonetheless advised NACHA that limiting returns to R15 and R14 for reclamations in the event of a death could be extremely problematic to the RDFI. For example, if a relative or executor of the deceased's estate closes the account, the RDFI's automated system will likely return subsequent entries to the account as R02 (Account Closed), and satisfy any need to inform an agency of the beneficiary's death through alternative means. If the RDFI is required to use R15 or R14 as proposed by FMS, some type of manual (i.e., costly) intervention on the part of the RDFI will be required.

## **B.2. Misdirected Federal Payments**

To notify a Federal agency of an incorrect account number (or other errors in an ACH entry), the RDFI is permitted under the NACHA Rules to send an Automated Notification of Change (“NOC,” SEC code – “COR”) to the agency to correct the account information. Moreover, the agency could send a prenotification entry which the RDFI is required to act upon, including a response with correct account information as necessary. Both approaches are efficient electronic processes. NACHA understands FMS’ concern with RDFIs not informing agencies when an account number is incorrect on recurring payments (with subsequent entries still containing the incorrect account number that is then “fixed” by the RDFI for correct posting). However, without more concrete information from FMS as to how prevalent this problem is, we are reluctant to extend unqualified support to FMS’ proposal to require that the RDFI respond to the initiating agency with correct account information.

If FMS does go on to require agency contact by RDFIs when there is an incorrect account number in an entry, we encourage FMS to clarify that sending a correcting NOC represents such contact. We would also strongly encourage FMS to review how well agencies act on NOCs when they receive them, since NACHA continues to hear complaints from members that Federal agencies often do not act when NOCs are sent.

**NACHA –THE ELECTRONIC PAYMENTS ASSOCIATION**  
**13665 Dulles Technology Drive – Suite 300**  
**Herndon, VA 20171**  
**[www.nacha.org](http://www.nacha.org)**