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October 20, 2003

Financial Management Service
U.S. Department of the Treasury
Room 423
401 14th Street, S.W.
Washington, D.C. 20227

Attention: Mr. Stephen M. Vajs
Director
Risk Management Division

Re: Proposed Amendment to 31 C.F.R. Part 210

Dear Sirs:

The New York Clearing House Association L.L.C. ("The Clearing House")¹ and Electronic Payments Network L.L.C. ("EPN")² are pleased to respond to the request of the U.S. Treasury Department's Financial Management Service ("FMS") for public comments on its proposal

¹ The members of The Clearing House are Bank of America, National Association; The Bank of New York; Bank One, National Association; Citibank, N.A.; Deutsche Bank Trust Company Americas; Fleet National Bank; HSBC Bank USA; JPMorgan Chase Bank; LaSalle Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

² EPN is the only private-sector provider of ACH-operator services in the United States, providing services to some 1,300 financial institutions. It is an affiliate of The Clearing House. Major financial institutions that are represented on EPN's board of directors are: ABN AMRO North America Holding Company; Bank of America Corporation; The Bank of New York Company, Inc.; Bank One Corporation; BB&T Corporation; Citigroup, Inc., Comerica Incorporated; Deutsche Bank Trust Corporation; Empire Corporate Federal Credit Union; FleetBoston Financial Corporation; HSBC North America, Inc.; J.P. Morgan Chase & Co.; KeyCorp; M&T Bank Corporation; Mellon Financial Corporation; The PNC Financial Services Group, Inc.; U.S. Bancorp; Wachovia Corporation; and Wells Fargo & Company.

to amend its regulation (part 210 of 31 C.F.R.) governing the use of the automated clearing house (“ACH”) system by federal agencies.³ As stated in FMS’s Federal Register notice, part 210 adopts, with some exceptions, the Operating Rules of the National Automated Clearing House Association (“NACHA Rules”).

Despite the general practice of following the NACHA Rules, last year FMS amended part 210 in a way that represented a significant departure from the NACHA Rules.⁴ The NACHA rules permit the conversion of checks into ACH debit entries under very limited circumstances. For example, the NACHA rules do not permit the conversion of the following kinds of check when they are received through the mail or at a drop box:

- (1) checks drawn on corporate or business accounts, (2) third-party checks, (3) demand drafts and third-party drafts that do not contain the signature of the Receiver, (4) credit card checks, (5) obligations of a financial institution, (e.g., travelers checks, cashiers checks, official checks, money orders, etc.), (6) checks drawn on the Treasury of the United States, a Federal Reserve Bank, or a Federal Home Loan Bank, (7) checks drawn on a state or local government, or (8) checks payable in a medium other than United States currency.⁵

The 2002 changes permitted federal agencies to convert business checks to ACH debit entries. The present proposal goes even further, eliminating all barriers to check conversion (except, ironically, drafts drawn on the U.S. Treasury). Under the proposed rules:

³ 68 Fed. Reg. 50,672 (Aug. 21, 2003).

⁴ 67 Fed. Reg. 17,895 (Apr. 11, 2002).

⁵ NACHA Rule 2.9.1.

1. Any check that cannot be converted to an ACH debit under NACHA's POP program⁶ will be converted to an ARC entry⁷ (if a consumer check) or a CCD debit entry⁸ (if a business check).
2. If an ACH debit is returned because the RDFI has placed a debit block on the receiver's account, the collecting agency will create a demand draft drawn on the receiver's account.
3. RDFIs will be required to use the R14 or R15 return reason codes where the receiver (i.e., the beneficiary) of a government ACH credit has died and is therefore no longer entitled to the payment.

The Clearing House and EPN strongly oppose these changes. We start with the proposition that "[t]he United States does business on business terms."⁹ While we recognize that the U.S. government is a very large enterprise that has certain sovereign and regulatory powers,

⁶ POP is an ACH debit entry created at the point of purchase using a check provided by a consumer. The merchant originating a POP entry must void the check and return it to the consumer after using it to obtain information from the MICR line. NACHA Rules §§ 2.2.1.11, 13.1.42.

⁷ ARC is an ACH debit entry that converts a consumer's check that the originator has received through the mail or in a drop box. NACHA Rules §§ 2.9, 13.1.6.

⁸ An CCD debit entry is a debit entry initiated by an organization to consolidate its funds by initiating debit entries to the accounts of its branches, franchises, agents, or from other organizations. NACHA Rules § 3.1.15.

⁹ United States v. National Exchange Bank, 270 U.S. 527, 534 (1926) (Holmes, J.).

we do not believe that these facts excuse its attempt to depart so radically from the rules that apply to every other ACH participant. Whatever their flaws, the NACHA Rules have been drafted with needs of all participants in mind. The check conversion rules, especially, have had to take account of the desire of some to move rapidly to a more electronic environment and the needs of those who issue checks and those who process for them. For these reasons, we believe that the federal government should follow the same rules that apply to every other ACH participant, absent a very compelling governmental interest.

We do not believe that FMS has demonstrated the compelling interest that would be needed to support its proposal. FMS has shown that adoption of the proposal would provide some added convenience to the government's check-collection activities, but it has not shown how this added convenience would be greater than the very real costs and burdens that it would impose on those that do business with the government or the financial institutions who process their payments. Most of all, FMS's proposal threatens to upset the careful balance that NACHA has achieved among those who continue to write checks, financial institutions, and those who receive checks, causing significant hardship for certain participants and creating confusion among participants about which rules apply in which circumstances.

Check Conversion

Each of the categories of checks that has been excluded from the ARC program was excluded because the banks that would receive ACH debit entries resulting from the conversions would have significant problems processing them.

Checks issued against line-of-credit accounts and credit card accounts are not processed by the bank's demand deposit accounting area. They are considered loans and are processed by the loan processing area. While consumer DDA processing will generally have links between check processing and ACH processing that would enable the RDFI to associate an ACH debit

with a check and report the debit as a check to the depositor, loan processing works differently, and an RDFI would have difficulty posting an ACH debit to the proper loan account.

Cashiers' check, tellers' checks, and like instruments would face even greater difficulties. These checks are usually used for important transactions and often are issued in large dollar values; they also represent a bank's own obligation to pay. Because of these factors, banks process these instruments carefully, in many cases, manually. When one of these items is converted to an ACH debit entry, the entry contains only limited information from the MICR line of the check; this information will not be sufficient for the issuing bank to guard against alterations and forgeries. The same will be true of the demand drafts that the government will issue in cases where an ACH entry is returned because of a debit block.

Adoption of this proposal will have an impact on financial institutions that will compound the already significant adverse impact that FMS's decision in 2002 to convert business checks is already having on RDFIs. When a business entity issues a check, it expects to get a check in return, and its processing procedures are set up with that expectation in mind. When a check is converted, it upsets that expectation, causes confusion, and leads to difficulty in posting and reconciliation. Businesses invariably contact their banks to help resolve the confusion, resulting in additional burden on the banks' customer-service units as the banks try to help the businesses resolve the problems. This burden is further compounded by the fact that when dealing with the government it is often difficult to find and contact the person who converted the check.

We understand that more widespread conversion of checks will reduce the cost and burden of the government's check-collection activities. But the net burden will not be reduced if the result is merely to shift the burden onto the private sector.

Use of Return Reason Codes

The NACHA Rules provide a number of return reason codes for RDFIs to use when returning an ACH entry that cannot be applied or posted. Return reason codes identify insufficient funds (R01), account closed (R02), payment stopped (R08), and other, similar reasons.¹⁰ If a depositor has died, the RDFI may use R14 (representative payee deceased or unable to continue in that capacity) or R15 (beneficiary or accountholder deceased).

FMS notes that when the beneficiary dies, some banks use the R02 (account closed) return reason code rather than the R14 or R15 return reason codes. If a federal agency receives an R14 or R15 return, it will automatically stop all future payments to the receiver, but when the agency receives an R02 return, it will temporarily suspend payments to the receiver.¹¹ FMS is therefore proposing that where a bank knows that the receiver has died, it be required to send returns with the appropriate R14 or R15 return reason code. Adoption of this proposal is likely to cause significant problems for banks and other financial institutions.

In the typical situation, the decedent's relatives come to the branch, show proof that the depositor has died, and show that they are entitled to any funds in the decedent's account. The branch officer issues a check for the balance in the account and closes the account, and the bank's system marks the account closed without any indication as to why the account was closed. If the bank receives an ACH entry for the account after that, the ACH processing system will recognize the account as closed and generate an R02 return.

It seems clear to us that under the present circumstances, the bank's ACH department does not have knowledge of the decedent's death and is not required to use an R14 or R15 return

¹⁰ NACHA Rules, Appendix 5.

¹¹ 68 Fed. Reg. at 50,674.

reason code. The proposed rule, however, seems to impute to the entire bank the branch officer's knowledge and to require the ACH department to act accordingly. In order to comply with this requirement, banks will have to undertake substantial systems changes at great cost. Formats for closed-account files will have to be reformatted to provide a field that indicates whether or not the accountholder is dead. The system architecture governing the files would have to be reprogrammed to provide rules as to how that information can be used (e.g., to generate R14 or R15 returns to the government but to generate R02 returns to other originators). The links to each of the systems that connect to the files would also have to be reprogrammed. For a single large bank, the cost of accomplishing these changes would be well in excess of a million dollars, and the cost to the industry as a whole would be hundreds of millions of dollars.

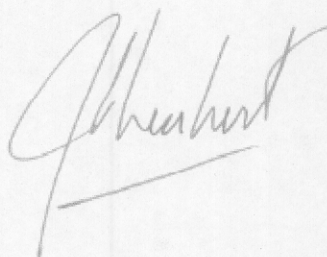
This is another instance of the government seeking a modest savings by imposing an enormous burden on the public. This does not meet even the most rudimentary cost-benefit analysis. FMS should withdraw this proposal.

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The Clearing House and EPN agree that the electronic payments offer substantial advantages over paper checks and that there are substantial benefits that result when payors use electronic payments instead of checks. Nevertheless, the conversion does present issues that need to be addressed in an orderly fashion; a rushed conversion that does not take account of these issues will be counterproductive. NACHA has attempted to strike the appropriate balance in its rules. While NACHA may be criticized for some of the choices it has made, its rules do represent a standard that provides a common ground for all participants, including the federal government. To have the government, with its sovereign power, unilaterally rewrite these rules to its own advantage and the detriment of just about everyone else does not serve the public interest and may in the long run actually set back the cause of electronic payments.

We hope these comments are helpful. If you have any questions, please call Joseph R. Alexander, Senior Counsel, at 212-612-9334.

Very truly yours,

A handwritten signature in cursive script, appearing to read "J. Alexander", with a horizontal line underneath the name.