

March 12, 2004

Via Facsimile

Ms. Jennifer Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Facsimile: (202) 452-3819

Re: Docket No. R-1176: Availability of Funds and Collection of Checks

Dear Ms. Johnson:

The Office of Advocacy of the U.S. Small Business Administration (SBA) submits this comment letter in response to the above-referenced proposed rule. These comments reflect concerns that small entities have voiced to the Office of Advocacy.

Advocacy Background

Congress established the Office of Advocacy (Advocacy) under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or of the Administration. Section 612 of the Regulatory Flexibility Act (RFA) requires Advocacy to monitor agency compliance with the RFA, as amended by the Small Business Regulatory Enforcement Fairness Act.¹

On August 13, 2002, President George W. Bush enhanced Advocacy's RFA mandate when he signed Executive Order 13272, which directs Federal agencies to implement policies protecting small entities when writing new rules and regulations.² The Executive Order (EO) also requires agencies to give every appropriate consideration to any comments provided by Advocacy. Under the EO, the agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.³

¹ Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

² Exec. Order No. 13272 § 1, 67 Fed. Reg. 53461 (Aug. 16, 2002).

³ Id.

The Proposed Rule

On January 8, 2004, the Board of Governors for the Federal Reserve (Board) published a notice of proposed rulemaking in the Federal Register on the *Availability of Funds and Collection of Checks*.⁴ The proposal implements the Check Clearing for the 21st Century Act (Act), which facilitates the broader use of electronic check processing by authorizing the use of a new negotiable instrument called a substitute check. Although the Act does not mandate that any bank change its current collection practices, all banks are required to educate their customers about electronic check clearing. The proposed rule: 1) sets forth the requirements of the Act that apply to banks; 2) provides a model disclosure and model notices relating to substitute checks; and 3) sets forth indorsement requirements for substitute checks.

The Requirements of the RFA

The RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Unless the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities, the agency is required to prepare an initial regulatory flexibility analysis (IRFA). The IRFA must include: (1) a description of the impact of the proposed rule on small entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives of, and legal basis for the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statutes and minimize any significant economic impact of the proposed rule on small entities. In preparing its IRFA, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.⁵

The Board's Compliance with the RFA

The Board prepared an IRFA to address its obligations under the RFA; however, Advocacy is concerned about the adequacy of the IRFA. Advocacy encourages the Board to provide a more thorough analysis of the proposed rule's impacts on small entities. For example, the Board's analysis should include a description and estimated number of small entities⁶ to which the proposed rule would apply; an estimate of the cost for implementing the proposal; and alternatives that the Board considered to minimize the economic impact on small entities.

⁴ 69 Fed. Reg. 1469-1501.

⁵ 5 U.S.C. § 603 and 5 U.S.C. § 607.

⁶ The RFA requires an agency to use SBA's small business size standard in complying with the RFA, unless the agency has consulted with the Office of Advocacy and published an alternate size standard for comment. See, 5 USC § 601(3). SBA's size standards can be found at <http://www.sba.gov/size/indextableofsize.html>. A search tool for looking up size standards can be located at https://eweb1.sba.gov/naics/dsp_naicssearch2.cfm.

Advocacy appreciates the fact that the Board solicited input on the impact of the proposed rule on small banks. The information that is provided in the Paperwork Reduction section could be used to estimate the potential economic impact as required by the RFA.

Moreover, Advocacy encourages the Board to consider possible alternatives to minimize the impact on small banks. For example, the model disclosure language is lengthy and complicated. If it were more concise, it may reduce some of the economic burden on small banks as well as provide information that the consumer can readily understand. Similarly, some of the costs of educating consumers could be offset by a consumer education campaign by the Board, similar to the campaign announcing its new currency.

Concerns of Small Banks

Small banks advised Advocacy of their concern about the costs associated with the mandatory disclosures, consumer education, and training employees about the requirements of the rule. Moreover, America's Community Bankers (ACB) is concerned that the provisions pertaining to the magnetic ink character recognition line would make processing substitute checks less efficient than processing paper checks. ACB also contends that the provisions pertaining to Automated Clearing House transactions and breaches of the Uniform Commercial Code warranties should not be included in the implementation of the Act. Advocacy encourages the Board to give full consideration to the comments and suggested alternatives of the industry to assure that small banks are able to process substitute checks with as much ease as they currently process paper checks.

Conclusion

The RFA requires agencies to consider the economic impact on small entities prior to proposing a rule and to provide the information on those impacts to the public for comment. Advocacy recommends that the Board publish a supplemental IRFA to provide small businesses with sufficient information to determine what impact, if any, the particular proposal will have on its operations. In addition to providing the public with specific information about the economic impact on the proposal, the supplemental IRFA should provide a meaningful discussion of alternatives that may minimize that impact.

The Office of Advocacy is available to assist the Board in its RFA compliance and to review a draft of the final regulatory flexibility analysis. If you have any questions, or if Advocacy can be

of any assistance, please do not hesitate to contact Jennifer Smith at (202) 205-6943. Thank you for the opportunity to comment on this important proposal.

Sincerely,

Thomas M. Sullivan
Chief Counsel for Advocacy

Jennifer A. Smith
Assistant Chief Counsel
for Economic Regulation

cc: Stephanie Martin, Associate General Counsel, Legal Division
Dr. John D. Graham, Administrator, Office of Information and Regulatory Affairs