

Commonwealth Credit Union  
P.O. Box 978  
Frankfort, KY 40601

3/12/04

Ms. Jennifer J. Johnson, Secretary  
Board of Governance of the Federal Reserve System

RE: CHECK 21 COMMENTS

Dear Ms. Johnson:

The purpose of this letter is to make known the comments of Commonwealth Credit Union (CCU) on the proposed rules for the Check 21 Act and amendments to Regulation CC. CCU is the largest credit union in Kentucky with over \$600 million in assets, serving recipients and annuitants of the Kentucky public retirement systems and their family members. We applaud the Federal Reserve Board's decision to take advantage of the technology available to financial institutions to expedite and to economize the check clearing process through this Act.

This act has the potential to increase the speed that automated checks will go from payer to paying bank using substitute checks, however, returns will continue to carry with them some manual processes which will not allow them to equally share in the increased speed of the Check 21 clearing process. For this reason, we agree with the board, using banking day instead of business day when determining the timing of compliance with consumer regulation associated with this regulation. This will help financial institutions to provide the service consumers deserve and to reasonably comply with the mandates of the regulation.

Our organization finds it helpful when the board provides a sample of their expectations such as sample notices to consumers for certain consumer check clearing situations. When financial institutions are also provided with the latitude to modify sample notices to fit the needs of our specific consumer base and account types, it allows us to incorporate regulations into our policies and practices with a more efficient outcome than no samples or rigid notice requirements.

We appreciate the opportunity to comment on existing and proposed Reg CC provisions. Concerning the new Reg CC provision to change the liability of financial institutions in specific situations, we have long held the opinion that the point of check presentment or benefactor (consumer, merchant or depository bank when acting as original point of presentment), should hold the responsibility for a check signed by a fraudulent payer. The check payment process would be improved by placing the liability with those who benefit or could reasonably control or protect against fraudulent checks. An example where this does not happen is with signature forgery. This crime and the losses associated with it could be reduced with dispute timeframes similar to the fraudulent endorsement, the 120 days allowed under the proposed expedited recredit procedures in Check 21 Act or the 60 days allowed for Reg E. This is because the point of presentment has the ability to place appropriate controls in place to confirm the

validity of the payment offered while the paying bank has no such opportunity. When losses are placed upon the entity or party with the ability to prevent the loss, incentives for proper controls will take place. There is no incentive for the payer to be dishonest or for the payee or merchant to have ineffective controls, when the loss for these actions will come back to them. Instead the incentive is to be who the customer says he is and for the payee or merchant to establish and maintain proper identity controls. Action to place more responsibility on the point of presentment would have an added benefit of making identity theft harder for those trying to pass fraudulent checks.

The same principles hold true concerning items drawn on consumer accounts at remote locations without a signature. These are often for the payment of fees or insurance premiums by preauthorized check agreements (individual agreements for insurance premiums or posted agreements in the case of return check fees). Holding the paying bank liable for these when the consumer claims they are unauthorized benefits the originating bank or entity without holding them responsible for losses associated with their benefits. This creates an inequitable advantage on the part of the originating entity and opens the process up to dishonest acts on the part of dishonest or poorly managed organizations at the cost of the properly acting paying bank. When the benefiting party is not required to take the associated losses, this creates opportunity for dishonesty and no incentive for poor management practices on their part. The originator has the ability to prevent, accept or work with the customer concerning potential losses. They are the party benefiting from the check payment process. They are the ones with the ability to put controls into place to protect themselves from losses as a result of these procedures. For all these reasons, the originating entity should be liable for any losses for unauthorized items, not the paying bank.

Finally, financial institutions may find it helpful if the Check 21 Act distinguished between a substitute check and a check converted to an ACH transaction (tran codes ARC, POP and RCK).

This Act is a revolutionary change in the right direction for check processing, for using available technology and for reducing fraud. The board has our complete support as it moves forward with the decisions required to make a smooth transition to the proposed changes. We have already started informing the appropriate staff about the changes to take place in October 2004. We look forward to your final rules. Once we have these, we will add to our staff training and begin educating our members. In addition, we will finalize the steps needed to make the Check 21 Act work at our institution.

Sincerely,

Donna R. Jackson, Comptroller  
800-228-6420, ext. 5237