Consumers Union
Publisher of Consumer Reports

West Coast Regional Office
1535 Mission St.
San Francisco, CA 94103
415-431-6747

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Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

By overnight delivery

Docket # R-1176, Check 21

These comments are filed by Consumers Union, the nonprofit publisher of *Consumer Reports*,[1] the Consumer Federation of America, U.S. PIRG, the National Consumer Law Center, and Consumer Action.

Check 21 treats an electronic transfer of funds initiated by check under check law, but at the same time provides some new consumer rights to accompany this fundamental change in how checks are processed. These consumer groups seek changes in the proposed rule and commentary to make the new consumer rights accessible. Although Check 21 fails to assure consumers a minimum package of rights that apply to *any* check that has been processed electronically, Check 21 does take an important first step toward consistency for consumers in payments law by including a consumer right of recredit with respect to substitute checks which is similar to the consumer's right of recredit under the Electronic Funds Transfer Act.

Check 21 provides consumers three important new rights. First, consumers whose checks are processed using a substitute check receive a special substitute check warranty. Second, consumers who receive a substitute check are indemnified from harm caused by not receiving the original check. Third, consumers receive a right to claim an expedited recredit for erroneous payment of a substitute check or for a warranty claim on a substitute check.

[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life of consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with approximately 4 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support. The other organizations signing this letter are described in Attachment 2.

We seek changes in the proposed rule and draft commentary to make these rights work for consumers. Check 21 is ambiguous about whether the right of recredit applies whenever a substitute check has been used, or only when the substitute check has also been provided to the consumer. The proposed rule narrows the scope of the recredit right by imposing an obligation that the substitute check be provided to the consumer before the right of recredit is triggered, and also by interpreting "was provided" to mean provided only on paper and not provided in electronic form. These two policy choices in the proposed rule should be reversed, so that the right of recredit will do the job contemplated by Congress of protecting consumers. Similarly, to the degree that the statute is read to require that the consumer be provided a substitute check in order to exercise the right of recredit, it is crucial that the regulation expressly recognize a consumer right to receive a substitute check on request. If a bank can simply deny the consumer's request for a substitute check, it could avoid all application of the key consumer right of recredit. In addition, the proposed rule omits a key statutory requirement for bank denial of a recredit to a consumer—that the bank demonstrate that the substitute check was properly charged to the consumer's account.

Consumers Union, the Consumer Federation of America, U.S. PIRG, the National Consumer Law Center, and Consumer Action seek these key changes in the text of the proposed rule:

- The rule should be changed to delete the requirement that the substitute check "was provided" to the consumer in order to trigger the right of recredit. This would resolve a statutory ambiguity in favor of more consumer protection through wider access to the right of recredit.

- The rule should be changed to treat the provision of an image of a substitute check, and the right to request a substitute check, as satisfying any precondition on the right of recredit that a substitute check "was provided" to the consumer.

- The rule must expressly require a bank to provide a substitute check to a consumer who requests a substitute check, an original check, or a copy of an original check. This is needed to prevent circumvention or evasion of Check 21.

- The rule should be changed to incorporate a key statutory precondition on a bank's denial of a recredit—that the bank has "demonstrated to the consumer that the substitute check was properly charged to the consumer account."

- The rule should direct banks to reverse NSF fees and other adverse consequences to the consumer after an error in processing a substitute check.

- The rule should disallow or place a strict time limit on reversal of a recredit after the bank has notified the consumer it has determined the claim to be valid.

- The substitute check notice should be sent to all consumers.

- The model consumer notice should be made more accurate, and the notice should be augmented to inform the consumer of shorter float and to answer this consumer question: "Where is my original check?"

- The Board should provide the model notices in both English and Spanish.

- The rule must require banks to accurately respond to consumer inquiries about how a particular check was processed and what rights and obligations attach to that check.

- The rule should prohibit non-bank creation of substitute checks.

Importance of these rules

The Check 21 rules are important because the non-return of an original paper check may be caused by one of several different ways in which the payment was processed, each with different consequences for the check writing consumer. Three identical checks written by one consumer can be processed differently, leading to three very different sets of rights and protections. These widely varying sets of consumer rights are: 1) Regulation E protection (electronic check conversion); 2) dollar-capped Regulation E-style Check 21 recredit protection (substitute checks); or 3) no recredit right (voluntary truncation by bank agreement).

These three very different sets of legal rights and remedies apply when the circumstances appear largely identical to the consumer, who simply wrote a check and did not receive the original check back.[2] This is already causing, and will continue to cause, significant consumer confusion. The Federal Reserve Board should reduce the opportunities for that confusion by interpreting the Check 21 right of recredit broadly, thus bringing at least the substitute check rule into closer alignment with the treatment of electronically converted checks covered by Regulation E.

The right of recredit is of high practical importance to consumers. Under traditional check law, a consumer's only remedies if a check is improperly paid are to persuade the bank to return the funds or sue the bank to enforce state law Uniform Commercial Code provisions. The Electronic Funds Transfer Act and Regulation E created a new, efficient, non-litigation remedy for consumers. That remedy is the right of recredit. With recredit, the consumer can get disputed funds put back into the account promptly. Recredit allows the consumer to avoid the harmful consequences of a dispute in the amount of a payment from the consumer's account, by getting the funds restored before a rent check bounces, a car insurance policy is cancelled due to an NSF check, or a late charge is incurred on a bill that would have been paid on time if not for the disputed funds being missing from the consumer's account. Recredit is easy and simple to invoke. A consumer can use recredit without a lawyer. Recredit avoids the expense and delay of litigation for all parties to the dispute. Congress chose to give consumers whose check processing is changed by Check 21 a right of recredit which strongly parallels the EFTA right. The changes we seek in the proposed rule and draft commentary are essential to making that right of recredit truly available to consumers.

The undersigned national consumer groups ask the Federal Reserve Board to use this rulemaking to bring the application and implementation of Check 21 closer to what Congress intended—that Check 21 would protect consumers while introducing more efficiency into the banking system. Because the right of recredit is crucial to protecting consumers, we ask the Federal Reserve

[2] While electronic check conversion of periodic payments requires consumer authorization, major billers are beginning to condition acceptance of checks on this authorization, placing a notice in the fine print that submission of a check constitutes authorization for electronic check conversion. Consumers Union is receiving calls from consumers who had no awareness that they had "consented" to electronic check conversion.

Board to make the right of recredit available to all consumers whose payments are processed using substitute checks or who have a substitute check returned to them. This interpretation of the scope of the right of recredit will reduce the practical differences between the rights available to consumers whose checks are processed in whole or in part as substitute checks as compared to consumers whose checks are subject to electronic check conversion.

Three key changes in the rule are needed to provide sufficient access to the right of recredit. First, the Board should resolve the ambiguity in the statute about whether or not a substitute check must have been provided to the consumer to trigger the right of recredit. The Board should resolve that ambiguity in favor of broader access to recredit. Second, if the rule does impose a requirement that the substitute check "was provided" to the consumer, then the Board should change the rule to allow the provision of an image of a substitute check provided pursuant to an agreement to satisfy any such "was provided" precondition on the right of recredit. Third, the rule must expressly require that a bank give the consumer a substitute check upon request for a substitute check, an original check, or a copy of the original check. As presently drafted, the rule makes the right of recredit wholly illusory because it ties that right to whether the consumer was provided a paper substitute check, but does not require that a bank ever provide that piece of paper, even on request of the consumer.

A fourth key change we seek is for the regulation to impose on banks a requirement already imposed by the statute: that an otherwise proper application for recredit cannot be denied unless the bank demonstrates to the consumer that the substitute check was properly charged to the consumer's account.

Our comments are organized as follows:

Recredit issues

The legislative history shows that Congress intended expedited recredit to be available to consumers when a substitute check was erroneously charged to the consumer's account.

The extensive statements in the legislative history that Check 21 was intended to protect consumers require that ambiguities in the statutory language be construed in favor of greater, not lesser, consumer protection. The legislative history indicates that Check 21 was intended to increase consumer protection. Congress Member Bachus, referring to an amendment offered by Congress Member Watt, stated: "Part of that language clarifies that nothing in this act shall diminish in any way and everything in this act shall preserve all consumer protections. In fact, we have added consumer protections in this act." 149 Cong. Rec. H 4987, June 5, 2003.

The right of recredit, in particular, was intended by Congress to enhance consumer rights, allowing consumers to get their money back without navigating the intricacies of the UCC. Thus, Congress Member Davis (AL) stated to the House in the Committee of the whole:

> I want to dwell for a minute on an act of simplification that this bill creates with respect to consumers. Right now, a good many of the people who are watching this or who are part of our districts have had the experience of looking at their bank ledgers and finding out that they have been credited [sic] for something that they did not think they wrote. A lot of people regularly run into these kinds of very small issues with the banking community, and those of us who went to law school can recall the portions of our bar books that summarize the UCC and the various protections, and they have been something of an imponderable maze.
>
> This bill improves that. The expedited recredit provision has a number of very simple but very important features.
>
> The first one is that if it is determined that a bank has falsely credited [sic] someone's account, within 1 day of that determination the bank must recredit the account. And there is a very specific window of time that is set to resolve a dispute. If a bank has not determined that a claim is valid within 10 business days, the bank has two options: either recrediting the lesser of the amount charged or $25 [sic: $2,500] with interest being recredited and any remaining amount with 45 calendar days. That is an important act of simplification.

149 Cong. Rec. H 4999-5000, June 5, 2003.

The first three items discussed below must be changed in order for the proposed rule to serve Congress' goal of offering recredit as a simple, accessible remedy when a substitute check was erroneously charged to a consumer's account.

The rule should not restrict recredit to a consumer who was provided with a substitute check.

Congress' intent should be honored by resolving a significant ambiguity in the statutory language of the recredit section in favor of more access to recredit. The first subsection of the recredit section of Check 21 talks about the claim existing when a substitute check "was provided" to the consumer; but the two more specific subsections on the procedures for claims and on when a bank must recredit a consumer account both omit any restriction on the right of recredit only to substitute checks that were provided to the consumer. Each of these two more specific subsections focus not on what was provided to consumer, but on what was charged against the consumer's account.

Section 7(a)(1)(A) of Check 21 states that, in general, a consumer may make a claim for expedited recredit if the consumer asserts in good faith that the bank charged the consumer's account for a substitute check that was provided to the consumer. However, the more specific "procedures for claims" provisions of subsection 7(b) do not require a consumer to allege or prove that he or she was provided with a substitute check. Even more importantly, subsection

7(c), states when "the bank shall recredit" a consumer's account without conditioning recredit upon the consumer having been provided with a substitute check. Under subsections (b) and (c), the availability of recredit depends upon whether a substitute check was properly charged to a consumer account, and whether the bank has both provided the consumer with the original check or an accurate copy of the original check and demonstrated to the consumer that the substitute check was properly charged to the consumer account.

Subsection 7(b) requires that the consumer give the bank a description of the claim, including an explanation of why the substitute check was not properly charged to the consumer's account or an explanation of the warranty claim with respect to such check. The consumer must also state that he or she suffered a loss, give an estimate of the amount of the loss, and give the reason why production of the original check or a better copy of the original check is necessary to determine the validity of the charge to the consumer's account or of the warranty claim. Finally, the consumer must give sufficient information to identify the substitute check and to investigate the claim. There is *no* requirement in subsection 7(b) that the consumer provide a copy of the substitute check, and *no* requirement that the consumer allege that she was provided with a substitute check. Instead, the claim procedure is focused on showing that a substitute check was erroneously charged to the consumer's account, and how that erroneous charge harmed the consumer.

Subsection 7(c) plainly states a bank's obligation to recredit a consumer account without limiting that obligation to those occasions when a substitute check was provided to the consumer. Subsection (c) requires that a bank "shall recredit a consumer account…for the amount of a substitute check that was charged against the consumer account" if the consumer submits a claim that meets the requirements of subsection (b) and the bank has not provided to the consumer the original check or a better copy of the original check and also demonstrated to the consumer that the substitute check was properly charged to the consumer account.

The availability of expedited recredit for a breach of a warranty claim is additional evidence that Congress did not intend to restrict the right of recredit solely to circumstances where a substitute check was provided to a consumer. Subsection 7(a) and 7(b) both refer to the availability of recredit for a check upon which the consumer has a warranty claim. The warranty, however, as defined in Section 5 of Check 21, is triggered by the transfer, presentment or return of a substitute check for consideration "regardless of whether the warrantee receives the substitute check or another paper or electronic form of the substitute check or original check." This language in Section 5 expressly defines the warranty claim to be available when a substitute check was charged to the account, regardless of what was provided to the consumer.

The substitute check warranty is a key warranty, protecting consumers against the risk of double payment when a substitute check has been used. It would make very little sense to structure the recredit right as a remedy for this "no double debit" warranty but then restrict recredit to when the consumer was provided a substitute check. The warranty explicitly runs to the consumer regardless of what the consumer has received, including a paper or electronic form or the substitute or the original check.

The legislative history strongly suggests that Congress intended the remedy of expedited recredit to be available to all consumers with a dispute about whether a substitute check was properly charged. The principal sponsor of the measure, Congress Member Ford, told the House

Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services:

> Finally, Check 21 establishes a new consumer right—an expedited re-credit for contested substitute checks. If a substitute check is not properly charged to a consumer's account, banks must re-credit the consumer for the amount of the check, up to $2,500, within 10 business days. This is a new and important consumer protection established by this bill.

Transcript of hearing on H.R. 1474—Check Clearing for the 21st Century Act, Committee on financial Institutions and Consumer Credit, Committee on Financial Services, April 8, 2003, p. 7.

Congress Member Ford similarly described the bill to the full House at the reading of the conference report: "Check 21 is a strongly pro-consumer bill." He described for the full House four areas in which Check 21 is pro-consumer, including:

> Fourth, Check 21 establishes a new and important consumer protection - an expedited recredit *for contested substitute checks.* A consumer who raises a dispute because a check that *has been rendered into a substitute has been improperly charged* to his account will receive a recredit within 10 business days, for amounts up to $2,500. This 'right of recredit' is an important part of this bill.

149 Cong. Rec. H 9290-9291 (Oct. 8, 2003) (italics added).

The bill's principal legislative sponsor described the right of recredit as a right which is available "*for contested substitute checks*" which have "*been improperly charged*." The scope of the right of recredit under the proposed rule is significantly narrower than this. The Congressional discussion ties the availability of the right of recredit to whether a substitute check has been improperly charged to a consumer's account, not to whether a substitute check was provided to the consumer. The bill's principal sponsor Congress Member Ford goes on to note that where there were differences in the House and Senate bills, "in each case, the conference adopted the pro-consumer position." He went on to point out that the conference report retains an amendment: "which stipulated that the consumer need not currently be in possession of the substitute check to enjoy the right of expedited recredit." 149 Cong. Rec. H 9291 (Oct. 8, 2003).

The Congressional intent that recredit be available to remedy a contested substitute check which has been improperly charged to a consumer's account can only be honored by resolving the statutory ambiguity between subsection 7(a), which refers to a substitute check having been provided, and subsections 7(b) and 7(c), which confer a right of recredit irrespective of whether a substitute check was provided, in favor of subsections 7(b) and 7(c). To do this, proposed Section 229.54(a) and the associated commentary must be changed to eliminate any "was provided" precondition to recredit.

If a "was provided" requirement is retained in the rule, then the rule and commentary should be changed to indicate that a consumer who receives an image of a substitute check was provided with a substitute check.

Under both Section 7(a) of the statute and Section 229.54(a) of the proposed rule, a consumer is entitled to make a claim for recredit "for a substitute check that was provided to the consumer." As discussed above, other parts of Section 7, including the subsection 7(c) that requires a bank to

make the recredit, do not make "was provided" a precondition to the right of recredit. If, however, this is retained as a precondition in the rule, then the scope of the recredit right will be significantly affected by how the triggering condition of "was provided" can be satisfied. This is not addressed in the statute. The commentary takes a too narrow approach, concluding that a substitute check cannot be provided to the consumer electronically. Comment 1 to Section 229.54(a) states that "a consumer that received only an image statement containing an image of a substitute check would not be entitled to make an expedited recredit claim…."

As banks enter into image statement agreements with their customers, it is more and more likely that the substitute check will be "provided" as an electronic image, rather than as a paper copy. The definitions state that a substitute check is a paper item but those definitions do not address the effect of providing that paper item electronically, in the same fashion that other documents required by law to be in writing can be provided electronically.

The rule permits a bank to discharge its obligation to a consumer to provide an original check or a sufficient copy by providing an electronic image, where the consumer has agreed to receive that information electronically. Sections 229.54(e)(2)(i), 229.58. At the same time, the commentary treats the provision of an electronic image of a substitute check to a consumer pursuant to an agreement as *not* qualifying as the provision of a substitute check sufficient to trigger the recredit right. Comment 1 to Section 229.54(a). Thus, the commentary allows a bank to satisfy its obligations to a consumer electronically, but does not allow a substitute check that was provided electronically to trigger a consumer's recredit rights. This makes no sense.

The commentary overstates the requirements of the statute when it says that a consumer may make a claim for expedited recredit only for a substitute check that he or she "has received." "Received" is not a requirement found in any part of Section 7 of Check 21. Section 7(a) discusses a substitute check that "was provided" to the consumer. Paper documents can be *provided* electronically, when the consumer has agreed to receive them electronically. This is the heart of the federal Electronic Signatures in Global and National Commerce Act (E-Sign). 12 U.S.C. § 7001.

As discussed above, we question whether, in fact, the statute restricts recredit to when a substitute check "was provided" to the consumer, and urge that the conflicting statements in subsection 7(a) as compared to subsections 7(b) and (c) be resolved in favor of the language of subsections 7(b) and (c) and the absence of any "was provided" requirement. However, the structure of Section 7 provides strong support for the conclusion that, *if* a substitute check must be provided to trigger the recredit right, it could be provided by making the substitute check available in electronic form or by making it available on request, as well as by including it with the statement. For example, subsection 7(a)(2) provides a rule for starting the consumer's time to make a claim. It does not tie that time period to the date that a substitute check was provided to the consumer. Instead, subsection 7(a)(2) triggers the time period for action by the consumer from the later of the date that the financial institution mails or delivers a periodic statement of account which contains the information concerning the transaction, or the date on which a substitute check is "made available" to the consumer. This suggests that making the substitute check available in electronic form, or available upon request, should be sufficient to satisfy any "was provided" precondition.

Subsection 7(h) also supports the interpretation that the consumer need not have been provided with a physical paper substitute check in order to exercise the right of recredit. This subsection

clarifies that a consumer who was provided a substitute check may make a claim for expedited recredit under Section 7 "whether or not the consumer is in possession of the substitute check." There are several reasons why a consumer would not be in possession of a substitute check which was provided to the consumer, including that the substitute check was lost, the substitute check was provided electronically, or that the provision of the substitute check occurred by giving the consumer a right to request the substitute check rather than by sending a physical paper document.

The author of this amendment, Congress Member Davis (AL), engaged in an extensive discussion with witnesses from Consumers Union and from the banks, expressing the view that consumer should be able to access the recredit right without a physical substitute check. Congress Member Davis:

> Let me ask you a fairly basic question. Do you or Mr. Cloutier or anybody else on the panel think that the substitute check is an important instrument in resolving a dispute between a consumer and the bank, or resolving some issue as to the amount of how much a check was written for? Do any of you think that a substitute check is a necessary part or even a very helpful part in getting to the bottom of that kind of a question?

Mr. Cole:

> Only to the extent that that is what is presented to our bank—if that is the evidence that we have. Now, we will also have that on microfilm, so it is very unimportant, actually. We will be using the records.

Congress Member Davis:

> So presumably what Ms. Duncan is saying is that obviously if someone walks in with a substitute check, that is a very strong argument in their quiver. But if they do not walk in with a substitute check, there are any number of other means for determining a dispute. That is presumably what she is saying. Now, given that, why isn't she correct? If the substitute check is not necessary to get to the bottom of a dispute between a consumer or customer and the bank, why should we differentiate between people who have a substitute check and those who do not with respect to the re-credit provisions?

Transcript of hearing on H.R. 1474—Check Clearing for the 21st Century Act, Committee of Financial Institutions, April 8, 2003, p. 53.

The rule and the commentary should be changed so that any precondition to recredit that a substitute check was provided is satisfied if the consumer was provided with either: 1) an image of a substitute check; or 2) another form of check image accompanied by a right to request a substitute check.

If the rule retains any "was provided" precondition on recredit, then the issue of whether that provision could be through an image significantly affects the scope of the right to recredit. The narrow interpretation in the draft commentary will restrict the right of recredit far more than necessary; is inconsistent with the principles of electronic provision of consumer information authorized by E-Sign; and will require consumers to learn about and engage in the extra step of requesting a paper substitute check in order to invoke the legal rights provided by the statute.

The extra step of requiring a paper form of the substitute check is inconsistent with the legislative history about the purpose of the recredit right. At the second House Subcommittee hearing on Check 21, Chairman Oxley stated that "there is little need for paper checks in today's payment system," then went on to say "This bill protects consumers by ensuring that they have *the ability to retrieve improperly debited funds* and are given information on the operation of this new system." Transcript of hearing on H.R. 1474—Check Clearing for the 21st Century Act, U.S. House of Representatives, Committee on Financial Institutions and Consumer Credit, Committee on Financial Services, April 8, 2003, p. 5 (italics added). Congress Member Hart, also a principal legislative sponsor of Check 21, told the House Subcommittee: "Consumers will benefit from a new expedited right of re-credit for amounts up to $2,500." Transcript of hearing on H.R. 1474—Check Clearing for the 21st Century Act, U.S. House of Representatives, Committee on Financial Institutions and Consumer Credit, Committee on Financial Services, April 8, 2003, p. 9.

It makes no sense to treat a consumer who receives a statement containing an image of a substitute check differently from a consumer who receives a paper substitute check. If there is a dispute about the payment of the check, that dispute is highly likely to be about the amount paid, the person to whom the check was paid, or the number of times the check was paid. None of these are any less of an issue because the consumer was given an image of a substitute check rather than a hard copy of the substitute check.[3]

The commentary's conclusion that a substitute check is insufficient to satisfy any "was provided" precondition on the recredit right also is inconsistent with principles of efficiency and economy in the banking system. Banks may wish to encourage consumers to accept image statements because they are cheaper to provide. Some consumers may want image statements, because they can more readily manipulate the information on a home computer, if the consumer feels that computer is sufficiently secure. However, if substitute check rights attach only when a physical paper substitute check is provided, and not when the substitute check is provided via an electronic image, then consumers can maximize their consumer rights only by behaving in the least efficient fashion for the banks—by insisting on paper substitute checks. Since image accounts are likely to permit the consumer to request a copy of an image received, it seems particularly illogical for the rule to deprive consumers who received an image form of a substitute check of the opportunity for recredit. The effect will either be to add delay while consumers seek physical paper substitute checks, or the loss of consumer rights due to lack of knowledge that the consumer's rights would improve if he or she requested a paper substitute check.

If the Federal Reserve Board resolves the ambiguity in the statute against consumer protection and retains the proposed rule's approach that recredit requires that a substitute check "was provided," then the Board should treat that requirement as satisfied by provision of an image of the substitute check, and by provision of another kind of image accompanied by the right to request a substitute check. This requires a change in Comment 1 to Section 229.54(a).

[3] The comments suggest that a consumer who receives an image of a substitute check will have the warranty, but not the recredit. Having the substitute check warranty without the recredit right is inadequate. The recredit right was added precisely because the remedies for check warranty generally available under the UCC are not practical for most consumers. Indeed, in describing the need for the right of recredit, as a more simple and usable right than any offered by the UCC, Congress Member Davis (AL) described the UCC as "something of an imponderable maze." 149 Cong. Rec. H 4999, June 5, 2003.

The rule must require a bank to provide the consumer with a substitute check in response to a request for a substitute check, an original check, or a copy of an original check.

The rule must be changed to expressly confer on consumers a right to receive a substitute check on request. If the right of recredit is to depend upon provision of a substitute check, and a bank can defeat that right simply by refusing to provide a substitute check when requested, then the right is truly illusory.

The legislative history does not suggest that Congress intended the Check 21 right of recredit to be an illusion or a sham. The bill's principal sponsor, Congress Member Ford, referred to the right of recredit as "a new protection for consumers." 149 Cong. Rec. H 4999, June 5, 2003.

Congress Member Bachus described the conference committee's action on Check 21, thus: "we have also added new consumer protections that go beyond present law." 149 Cong. Rec. H 9292 (Oct. 8, 2003). Congress Member Frank also referred to the fact that in the bill: "We add new protections for consumers." He referred to the right of recredit, as already described by Mr. Ford, as one of those protections. 149 Cong. Rec. H 9292 (Oct. 8, 2003).

The legislative history also reveals Congress' expectation that consumers would in fact be able to get substitute checks under Check 21. Chairman Oxley told the full House, in introducing the conference report on H.R. 1474: "businesses and consumers continue to have the option of accepting checks in paper form." 149 Cong. Rec. H 9290, Oct. 8, 2003. Congress Member Bachus stated that consumers will have a right to get a substitute check under Check 21. In response to a question by Congress Member Sanders about how many people in fact willed be getting substitute checks, Congress Member Bachus stated: "*And she will have a right to get those, so she will have that right if she wants it. She can request it*." Transcript of hearing on H.R. 1474—Check Clearing for the 21st Century Act, U.S. House of Representatives, Committee on Financial Institutions and Consumer Credit, Committee on Financial Services, April 8, 2003, p. 11 (italics added). Congress Member Frank told the full House that the Act promotes efficiency "while protecting consumers," stating: "This bill, as I said, does do that with regard *to your ability to get the check if you actually need it*." 149 Cong. Rec. H 4996 (italics added). Referring to a consumer's access to a substitute check, the Federal Reserve Board's Dr. Ferguson assured the House Subcommittee that consumers "*simply have to request one*." Transcript of hearing on H.R. 1474—Check Clearing for the 21st Century Act, U.S. House of Representatives, Committee on Financial Institutions and Consumer Credit, Committee on Financial Services, April 8, 2003, p. 23 (italics added).

The Board's Vice Chairman also told Senators that consumers have a right under Check 21 to receive a paper substitute check on request. He stated to the Committee on Banking, Housing and Urban Affairs of the U.S. Senate:

> I have been privileged to work with this committee on one such initiative, the Check Truncation Act, or Check 21. This legislation removes a legal impediment and should, over time, foster greater use of electronics in the check clearing process *while also preserving the rights of consumers* and *banks to receive paper checks.*

Testimony of Vice Chairman Roger W. Ferguson, Jr., statement on his renomination as Vice Chairman of the Board, to the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Oct. 14, 2003, p. 3.

If a bank can simply refuse to provide a consumer with a substitute check even on request, then the right of recredit will be easily evaded. Congress gave the Board the authority to prescribe regulations "as may be necessary to implement, prevent circumvention or evasion of, or facilitate compliance with the provisions of this Act." Check 21, Section 15. The Board should prevent evasion of the recredit right by requiring depositary and payee banks to provide a consumer with a substitute check on request. Since consumers may not know exactly what to ask for, the obligation to provide a substitute check should apply when the consumer requests a substitute check, an original check, or a copy of an original check.

The rule does not adequately set forth the standards a bank must meet to find a recredit claim invalid. It omits the key statutory requirement that the recredit must be given if the bank has not "demonstrated to the consumer that the substitute check was properly charged to the consumer account."

Section 7(c) of Check 21 requires that a bank must recredit the consumer's account, when the consumer submits a claim meeting the procedural requirements of Section 7(b), if the bank has not both provided the original check or an accurate copy of the original check and "demonstrated to the consumer that the substitute check was properly charged to the consumer account." Section 7(c)(1)(B)(i)(II). The proposed rule, by contrast, entirely omits the obligation of a bank which denies a claim to demonstrate that the substitute check was properly charged to the consumer account. The proposed rule simply tells a bank what to do if it determines a claim to be valid or invalid, but the rule is silent on how a bank is to make that determination. Section 229.54(c)(1) and (2). This silence suggests a degree of discretion in the bank which is wholly inconsistent with the statute, and which omits a key consumer protection adopted by Congress—that a bank shall recredit the consumer's account if the bank has not "demonstrated to the consumer that the substitute check was properly charged to the consumer account." Section 229.54(c) of the proposed rule must be revised to incorporate this requirement of Section 7(c)(1)(B)(i)(II) of the Act.

The rule should make it clear that the consumer, not the bank, determines whether a copy is sufficient to resolve the dispute.

The statute refers to the original check or a better copy of the original check. The rule replaces "better copy" with "sufficient copy," but does not state in Section 229.54 on recredit or in the definition of "sufficient copy" in Section 229.2(aaa) who decides whether a copy is sufficient. The concept of "sufficient copy" should not replace the statutory requirement for a "better copy," unless the rule also requires that, for a copy to be sufficient, it is either a better copy than what has previously been provided to the consumer, or it is a copy which otherwise resolves the dispute to the customer's satisfaction; that is, a copy that the consumer deems to be sufficient.

If a bank can make a unilateral decision that a copy is sufficient, the consumer will not be put in the same place by Check 21 as if the original check had been provided. Allowing the consumer, rather than a bank, to determine a sufficiency of the copy is one way to ensure that a bank does

not attempt to satisfy the statutory obligation to provide a better copy with a copy that is not adequate to resolve the dispute. This change will also prevent a bank from simply reproviding to the consumer the same document which the consumer has already found to be inadequate. Giving the consumer another copy of what he or she has already found to be insufficient, and about which a claim has been filed, cannot meet the statutory requirement for production of either the "original check or a better copy" of the original check. The proposed rule's use of the term "sufficient copy" should not change that result.

The rule should be changed to clarify that an oral claim is timely even if information is required in writing.

Comments 7 and 9 to Section 229.54(b) say that a bank may insist on a written claim, rather than on written information in support of a timely oral claim. This is inconsistent with the statute, which permits an oral claim. We do not object to the portion of Section 229.54(b) that starts the time clock for bank action from the submission of the information which the bank is permitted to require in writing. However, the commentary errs when it characterizes the written submission as the actual claim when there has been a prior oral claim. This makes a difference in determining whether a claim is timely.

Section 7(a)(1) of Check 21 defines a claim without requiring that it be in writing. A bank's exercise of its discretion to require that the information be provided in writing does not prevent the initial oral claim from satisfying the time period requirement. Section 7(b)(2) refers to the discretion of the bank to require the consumer to submit "the information" in writing, not to any discretion in the bank to require that the claim *itself* be submitted in writing. The claim exists when it is made orally, even if the bank subsequently exercises its right to require that information be provided in writing. The oral claim should satisfy the time period for action by the consumer. The rule should be augmented, and comments 7 and 9 to Section 229.54(b) changed, to make this clear.

The rule should be augmented to obligate the bank to inform the consumer of an incomplete claim.

Comment 10 to Section 229.54(b) states that an incomplete claim is "not a claim for purposes of § 229.54." If an incomplete claim is not a claim, then there will be no obligation under the statute or rule to tell the consumer that the claim has been denied, or even that it is incomplete. This could lead to abuse. The rule and commentary should either include an incomplete claim as a claim for purposes of notice of denial of the claim, or the Federal Reserve Board, acting under the general implementing power conferred by Section 15 of the Act, should augment the rule to require that a bank give the consumer notice: 1) that the claim is incomplete and does not qualify as a claim, and 2) what additional information would have to be provided to complete the claim. This is particularly important when the incompleteness could be remedied before expiration of the time to make a claim. If the consumer receives no notice that the claim is incomplete, the time to submit a proper claim could expire while the consumer waits for the bank to act on the incomplete claim. The rule should not permit a bank to simply ignore a claim which the consumer has no reason to know is incomplete.

The rule should direct banks to reverse NSF fees and other adverse consequences to the consumer after an error in processing a substitute check.

The rule should be augmented to require that a bank reverse NSF fees and other adverse actions caused by wrongful payment of a substitute check once the bank has determined that a substitute check was paid in error, such as for the wrong amount, to the wrong person, paid twice, or another error. The statute and proposed rule are silent about the handling of an NSF fee which was imposed on a substitute check that is later the subject of a dispute, and about NSF fees that were imposed on other checks which would have cleared if not for the payment of the disputed check which is subsequently reversed. The commentary does recognize that NSF fees caused by an erroneous debit are proximately caused losses covered by the substitute check warranty. Comment 2, example a, to Section 229.53(b)(indemnity). However, there is no discussion of an obligation to reverse these charges when a recredit is given, or to reverse other adverse actions stemming from the erroneous payment, such as a report to ChexSystems or a similar entity, an overdraft fee, or an internal "account overdrawn" counter which affects future funds availability.

The rule, or at least the commentary, should remind banks of the general obligation not to charge or retain fees from consumers that are not owed, and not to take or maintain an action that adversely affects the consumer which is not grounded in contract and in fact. For this reason, after a bank determines that a claim for recredit is valid, the rule should require that the bank reverse associated NSF and overdraft fees, withdraw or correct reports to ChexSystems or other account history databases, and reverse any other adverse actions by the bank against the consumer flowing from what the bank has determined was an error. If such corrections are not required to be automatic, then the consumer and the bank would have to engage in the economically wasteful activity of a separate warranty claim solely to address these additional proximately caused losses after the main issue has been resolved through the recredit process. Less sophisticated consumers are unlikely to pursue that claim, and thus will be the ones who suffer the continuation of unjustified adverse consequences.

The rule should disallow or place a strict time limit on reversal of a recredit after the bank has notified the consumer it has determined the claim to be valid.

Section 229.54(c)(4) allows a bank to reverse a recredit given under (c)(1) or (c)(3). The rule places no time limit on how long after the recredit the bank may reverse, and the rule permits a reversal even after the bank has notified the consumer that the bank determined the consumer's claim to be valid. Comment 2 to Section 229.54(c) says that the reversal may be "at any time later."

Although the statute permits reversal after a finding of a valid claim, the Federal Reserve Board should use its Section 15 implementing authority to prohibit or at least strictly limit the time period for reversal after the bank determinates that a claim is valid. An open-ended time for reversal is unfair and impractical for the consumer. Consumers need to know how much money they have available for family expenses. A long-delayed reversal of a recredit, or indeed any reversal after the bank has notified the consumer that the bank has found the claim to be valid, will interfere with certainty and household budgeting. Once a bank has notified a consumer that a claim is valid, there should be no opportunity for reversal. If this cannot be done, then a time ~~a~~ period of no more than 10 days should be provided for a reversal of a recredit after the bank notifies the consumer that the claim has been granted. We do not suggest, of course, that the

time period for reversing a provisional recredit be changed, but only that there should be enhanced certainty for consumers once a bank determines that a claim is valid.

The rule or commentary should prohibit a bank from charging any fees in connection with a request for recredit.

The rule or the commentary should remind banks that they may not charge the consumer a fee for copies of the documents relied upon in denying or reversing a recredit, nor a fee for an investigation into a claim for recredit.

The commentary should not refer to the bank's "belief" that the check was properly charged.

Comment 2 to Section 229.54(e) directs a bank denying a recredit claim to explain the reason for the denial, "such as the reason the bank *believes* the substitute check was proper…." (italics added). This language should be changed. Check 21 allows a bank to deny a claim for recredit when the bank has "*demonstrated* to the consumer that the substitute check was properly charged to the consumer account." Section 7(c)(i)(B)(i)(II). (italics added). The commentary should not suggest a lesser standard.

Examples in the commentary of the application of recredit for a double debit would be useful.

An additional area of the concern at the time Congress considered Check 21 was double debit. This issue is well-covered in the comments on Section 229.52(a) on the content of the substitute check warranty, but the commentary on recredit does not explain how warranty and recredit fit together. The recredit commentary should include examples of how the recredit would be used in seeking to rectify a double debit. It should include examples where: 1) both the original and a substitute check were charged, 2) two substitute checks were created and charged, and 3) a substitute check was charged and there was also an ACH charge arising from the same information. These examples should make it clear that the recredit right applies regardless of the order in which the erroneous charges occurred.

Comment 5 to Section 229.52(a) implies, but does not state, that whether the substitute check was the first or second item to be charged does not affect the validity of the warranty claim. It would be helpful to make this clear. Comment 5 to Section 229.52(a) on warranty is also helpful in that it makes clear that the double debit claim is in no way dependent on fault. It clarifies that the warranty applies even where the demand for duplicate payment arises from a fraud which has been perpetrated on both the bank and the consumer.

Warranty issues

Substitute check warranty coverage for an ACH payment is appropriate only if it does not disturb application of Regulation E.

If one of two payments stemming from the same check was an ACH payment, then that transaction will involve both the substitute check warranty against double payment and Regulation E. The proposal asks whether information from a check used to create an ACH data entry should be a payment request covered by the substitute check warranty. We believe that it should, but only if this characterization will not interfere with application of Regulation E as well to that payment transaction. If only one legal scheme can apply to an ACH payment originating from a substitute check, then the Board should choose Regulation E, which is more protective of consumers.

Comment 1 to Section 229.53(b) and its examples are useful.

This comment gives very useful examples of how damages are measured in a warranty claim, including the treatment of NSF fees and attorneys fees. The example on the effect of the absence of a legal equivalence legend also is helpful.

Consumer notice issues

All consumers need the substitute check notice.

The statute directly requires notice about the nature and rights attaching to substitute checks only for consumers who receive original checks or substitute checks. Check 21, Section 12. Section 229.57(b) thus describes the distribution of notices only for consumers who receive paid checks with periodic statements or who receive a substitute check. The Board should use its Section 15 authority to require that the notice be given to *all* consumers whose accounts include a checking feature, not later than the first scheduled communication after October 28, 2004. While it is useful for the notice to accompany a substitute check sent in response to a request for an original check, receipt of the substitute check should not be the only trigger for that notice for consumers not otherwise receiving original or substitute checks.

How will the consumer even know to request a substitute check without the notice? A consumer who is not currently receiving original paid checks, and may not even know what a substitute check is, has the same need to understand the nature of substitute checks and to know about the warranty, indemnity, and recredit rights as any other consumer. Further, because the substitute check warranty applies whenever a substitute check has been *used*, all consumers should be given a notice explaining the concept of substitute checks, how they may be used, and what rights apply.

We urge the Board to exercise its implementing authority under Section 15 of the Check 21 Act to require that the consumer notice be given to all consumer checking account customers, not merely to those who request or receive original or substitute checks.

The key model consumer notice inaccurately tells consumers that recredit is limited to losses "because you received a substitute check."

Notice C5-A, Substitute Check Policy Disclosure, is inaccurate. This notice states in the second paragraph: "If you lose money *because you received* a substitute check, you have the right to file a claim for an expedited refund." Later, the text of the notice more accurately states that federal law gives consumers the right to an expedited refund if the substitute check was incorrectly charged to the consumer's account, there was a loss to the consumer, and the original check or a better copy is needed. However, the earlier statement—that the loss must be "because" of receipt of the substitute check—is inaccurate. In fact, the basis for a right of recredit is that a substitute check was either not properly charged to the consumer's account or the consumer has a warranty claim, and the consumer suffered a loss. Check 21, Section 7. The statute does not restrict recredit to circumstances where the loss was "because" of receipt of a substitute check. The "because" statement in the draft notice is misleading and should be eliminated.

The notice should tell the consumer that he or she may also have a warranty right.

The notice says it describes "the rights that you will have when you *receive* substitute checks." There is a strong implication in this language that a consumer has rights with respect to substitute checks *only* when the consumer receives a substitute check. Whether or not recredit requires that the consumer was provided with a substitute check, the warranty right is independent of provision to the consumer of a substitute check. Describing the consumer's new substitute check rights as if they are triggered only by receipt of a substitute check is likely to mislead consumers. In general, the notice is not designed to inform consumers about the warranty right, which attaches to use of a substitute check regardless of what is or is not returned to the consumer. However, consumers need this information.

The use of the term "send" in the notice implies that oral claims not permitted.

The text under "expedited refund" says "you must send us a claim." Because Section 7 of Check 21 allows for an oral claim, the phrase "you must send" is inaccurate. Even if the bank insists upon supplemental written information, the consumer is *not* required by statute to send a written claim, but rather to follow up the oral claim with certain requested written information. It would be more accurate to say "you must make a claim."

The notice should directly answer the question: "Where is my original check?"

The notice should answer a key question that will be on consumers' minds—"What happened to my original check?" The notice should tell the consumers that if the consumer wants his or her original check, or a copy of it, to ask for a substitute check. It should also tell consumers that they have the right to receive a substitute check on request.

The notice should inform consumers of a key consequence of Check 21—shorter float.

A key consequence for consumers of Check 21 is that checks written by consumers will clear faster. Consumers who may have an expectation about float on the checks they write are likely to find more checks bouncing. While the statute does not require that the notice inform consumers about reduced float, failing to do so will lead to more bounced checks, more NSF fee revenue for banks, and more financial headaches for consumers. The basic notice about substitute checks should be modified to tell consumers that the statute will speed up check clearing so that the checks which consumers write are likely to be presented against their accounts sooner. Sample language for this and several other suggested changes is provided in the attachment following these comments. Some of the items we suggest adding to the model notice are not required by the statute, but the Board could require them under its Section 15 implementing authority.

The Board should provide the model notices in plain language.

We strongly suggest that the Federal Reserve Board seek input on the model forms from a plain language expert and make them as simple as possible, so that they will be more useful to consumers. There is always a tension between high levels of technical accuracy and plain language. However, an extremely accurate notice is of no use to consumers if most consumers do not understand it.

The Board should provide the model notices in both English and Spanish.

The Board should publish the model notice forms in both English and Spanish. While the commentary points out that a bank may provide the disclosures in Spanish, so long as the English-language disclosures are available upon request, it would be much more helpful for the Board to provide a set of the actual model forms in Spanish. This could increase the number of banks who choose to provide the disclosure in both languages, thus helping to educate more consumers about their rights and obligations under Check 21.

The rule must require banks to accurately respond to consumer inquiries about how a particular check was processed and what rights and obligations attach to that check.

Since the passage of Check 21, Consumers Union has been receiving questions from consumers and the media. These questions are posed as questions about Check 21, but they are coming mostly from persons who have experienced non-return of a paper check due to electronic check conversion. The nature of these questions suggests that consumers, members of the media, and possibly even some bank employees may be mixing up check conversion, which is fully covered by Regulation E, with Check 21-check imaging, which is not. A Chicago journalist who called several local banks in February 2004 told Consumers Union that the bank employees he spoke to could not explain to him what had happened to his paper check, or why his paper check was unavailable. Some of the consumers who have contacted Consumers Union contacted their banks first, and formed an impression that Check 21 was the reason that they did not receive back an original check. Conversations between Consumers Union and those consumers revealed that their original checks were non-returned for a different reason—the checks were subject to

electronic check conversion by non-bank payees. Telling consumers that a check was processed under Check 21 when it in fact was processed under electronic check conversion would be misleading and deceptive, because consumers have recredit rights for electronic check conversion transactions with no dollar cap under Regulation E.

If these kinds of questions and confusion are arising now, before Check 21 is effective, they can be expected to be more widespread once Check 21 goes into effect. The Federal Reserve Board should add to the proposed rule an obligation on banks to clearly and *accurately* respond to consumer inquiries about why the consumer has not received an original check, and about how a check was processed. These responses should include accurate information to the consumer about what set of rights and responsibilities apply to any particular check.

Banks might argue that it is difficult to tell how a check has been processed and what legal rights apply, but if even the bank can't tell, how is a consumer to determine what has happened to her check, and to identify her rights and obligations when something has gone wrong? As with several of the other notice issues, the Federal Reserve Board could impose such a requirement in the rule under its Section 15 implementing authority.

The rule should require banks to tell consumers when they request an original check or a copy of an original check that they may request a substitute check which is legally equivalent to the original check.

A key purpose of the substitute check is to put consumers in the same place as if they have received the original check. This purpose cannot be served if a consumer who contacts his or her bank and asks for the original check is told: "We don't have the original check," without also being told about the existence and availability of the substitute check. The rule should expressly require banks to tell consumers about the availability of a legally equivalent copy of the original check when a consumer asks for the original check or for a copy of the original check.

The rule should expressly require compliance with E-Sign for notices to consumers.

Section 229.58 allows delivery of notices or other information by mail or by any other means agreed to by the consumer. The rule should be clarified to ensure that it authorizes delivery to a consumer by electronic means only when the requirements of E-Sign, including a consumer consent meeting the standards of E-Sign, have been met.

Because E-Sign addresses requirements that would otherwise be required by law to be in writing, a simple rule authorizing electronic delivery "if agreed" could be read to remove the notice covered by that standard from E-Sign, by removing the threshold requirement in the underlying statute or rule that the notice or information be provided in writing. The commentary suggests that there was no intent to undermine application of E-Sign, at least with respect to a bank's communications with its consumers.

Section 229.58 should be altered to condition the authorization for electronic delivery to consumers on compliance with E-Sign, closing off an assertion that a generalized "agreement" not complying with E-Sign's consent standards would be sufficient. The handling of this issue in the commentary is not sufficient to resolve this problem. Comments 37 and 38 to Section

229.2(ddd) say that compliance with E-Sign satisfies the requirement for written notice to a bank's consumer, but they do not say that compliance with E-Sign is necessary to give the notice in electronic form. The rule and commentary should require E-Sign compliance for communications with the bank's consumers.

Other substitute check issues

Non-bank creation of substitute checks will increase consumer confusion and should be prohibited.

We appreciate the acknowledgement in the commentary at Comment 2 to Section 229.51(a) that if a non-bank can create a substitute check, then the bank of first deposit must accept responsibility for, and make warranties about, that substitute check. However, we are concerned that permitting a non-bank to create a substitute check will make it extremely difficult for consumers to determine whether an electronically processed check is covered by Check 21 (as a substitute check) or by Regulation E (as an electronic check conversion). It is confusing enough for consumers that merchants convert checks under Regulation E, while banks may create either substitute checks with similar but more limited rights, or images of original checks that lack even substitute check rights. However, if a non-bank payee can take a single check and either create a substitute check or perform an electronic check conversion, the consumer's ability to find out what happened, and thus what consumer rights apply, may be hopelessly muddied.

Now, consumers are often able to learn that it was the payee who transformed a check for electronic processing. The consumer should not also have to determine what the payee called that transformation. A bank that permits its customers to both use electronic check conversion and to create Check 21 substitute checks will violate Regulation E in handling a dispute if it gives the consumer erroneous information about which method was used, since the right of expedited recredit under Regulation E is broader; for example, it has no dollar cap.

The only solution we see to this maze is for the Federal Reserve Board to draw a clean line between electronic check conversion and substitute checks by using its Section 15 implementing authority under Check 21 to restrict the creation of substitute checks to banks. Non-bank payees who wish to transform checks for electronic processing can continue to do so through electronic check conversion, with all the protections of Regulation E for the consumer. Banks will be able to inform consumers quite simply what scheme applies—Regulation E if the payee converted the check; Check 21 if a bank created a substitute check.

The treatment of a purported substitute check with a MICR error as a substitute check is appropriate, but the concept should also apply to other types of errors on paid substitute checks.

We favor the special rule in section 229.51(c) of the proposed rule on purported substitute checks, but it may be too narrow. We agree that it is necessary to treat as a substitute check, for the purposes of warranty, indemnity, and recredit, an item that would be a substitute check if not for a MICR line error. Any other result would put a significant loophole in the substitute check protections. However, we question why only a MICR line error should qualify a purported

substitute check for treatment as a substitute check, and for attachment of the substitute check warranty if that purported substitute check has been paid.

Once a purported substitute check has been paid, the consumer has the same need for the warranties, indemnity, expedited recredit, and liability provisions for that defective, but paid, substitute check as for a defective substitute check with a MICR line error. We do not suggest that a defective substitute check must be paid, but rather that *if* a defective substitute check has been paid, then it should be subject to the same consumer rights, perhaps other than legal equivalence, which attach to a non-defective substitute check. We suggest that this section of the rule be augmented to state that paid items which would be substitute checks if not for defects other than a MICR line error are also substitute checks for purposes of Sections 229.52- 229.57.

The rule also should clarify that if the reason that the substitute check is defective is the absence of the "legal equivalence" legend, but the defective substitute check has been paid, then state law consumer rights and remedies apply to the same extent as if the check were a substitute check, at least for all purposes except legal equivalence. Without such a rule, consumers could be in the odd position of having substitute check rights with respect to a paid but defective substitute check, but not ordinary state law check warranties with respect that same paid check. This conundrum is created because state law uses the term "check" and since a defective substitute check is not legally equivalent to a check, state law rights can't attach to it even though it has been paid.

There should be a copy of both the original check and the original source document for creation of a substitute check somewhere in the banking system.

State law requires that a copy of the original check be retained for seven years. Because a substitute check can be created either from an original check or from a previously truncated check, it seems that there will be instances where there will be no one in the payments system who has an obligation to retain a copy of the source document from which the substitute check was created. There will be some instances where the substitute check or a better copy of the substitute check is insufficient to resolve a dispute. Consumers might well ask for a copy of the document from which the substitute check was first created. When that document is the original check, state law already provides that at least a copy be retained, but when that source document is not the original check, the proposed rule includes no requirement that anyone retain a copy of that source document.

Under electronic check conversion, one of the most common consumer questions Consumers Union has received is: "How could the merchant destroy my check? How do I prove the amount of my check after they have destroyed it?"

It appears that neither Check 21 nor state law would require anyone in the chain of payment to retain a copy of a source document, other than an original check, from which the substitute check is created. State Uniform Commercial Code law requires retention only of a legible copy of the original paper check. Under the "legal equivalence" rule in Check 21, that requirement would be satisfied by retaining a copy of the substitute check. However, there appears to be no obligation in current state law, and no obligation stated directly in Check 21, for any bank in the chain to retain a copy of any other kind of source document for a substitute check.

Consumers are highly likely to find this result unsatisfactory. It is one thing tell consumers that they will no longer get the original checks back as a matter of course, it is quite another to tell consumers that the document from which the substitute check was created has been destroyed and no one in the payment chain has a copy of it.

Disclosures are not in a form the consumer may keep if they can be downloaded but not printed.

Comment 38 to section 229.2(ddd) states that a notice is in a form the customer may keep if "it can be downloaded *or* printed." A printable notice is in a form that the consumer may keep. A form which is both downloadable and printable also should qualify. However, Comment 38 also defines a document as being in a form that the consumer may keep even that document can only be downloaded, but not printed, by the consumer. To avoid this problem, the commentary should be changed to refer to the notice in a form which "can be printed, or can be downloaded *and printed*."

Specific requests by the Board for comment

Issue A: Treatment of generally applicable industry standards.

To the maximum extent possible, the commentary should identity the relevant industry standards. If several standards are appropriate, each should be mentioned. Members of the industry may be familiar with these, but the commentary should also be useful to consumers and their lawyers, who may attempt to determine whether the appropriate standard has been followed. Referencing the appropriate standard in the commentary may also help to reduce disputes about whether the proper standard has been used.

There is an important related issue. Generally applicable industry standards are used to determine the size of a substitute check. The commentary to Section 229.2(zz) should be augmented to point out that if industry standards develop in a way that makes a substitute check difficult for recipients to read or use, continued deference to those standards will defeat the purpose of the substitute check, which is supposed to be as usable to the consumer as the original paper check. The commentary should remind the banking industry that if industry standards develop in such a way that the substitute check is too small or otherwise lacks usability for individuals, the Board could exercise its regulatory power under Section 15 of the Act to determine that those standards are no longer the proper measure for the adequacy of a substitute check.

Issue B: Relation of Check 21 to other law.

The commentary should describe the various ways that a check can be processed electronically which are not Check 21 transactions at all, but instead are fully covered by federal Regulation E. This is necessary because how the check is processed electronically after leaving the consumer's hands determines what law applies. Persons who know only that an original check was not returned may look to the Check 21 rule when they should be looking to the Regulation E

material on electronic check conversion. The commentary should describe and distinguish between these different types of transactions, and cross reference the electronic check conversion material.

The commentary should also describe the practical effect of legal equivalence for a person who has written a check and now needs proof of payment. The commentary should give examples where persons to whom the check was written must accept the substitute check as proof of payment, including such common examples as landlords, creditors, debt collectors and the Internal Revenue Service.

Issue C: Remotely–created consumer demand drafts.

The Board asks for comment on whether the UCC revisions addressing remotely-created consumer checks should be incorporated into Regulation CC. In general, we believe that this is a good idea. However, any incorporation of those rules into Regulation CC should make it clear that the effect of those rules is to shift the relative rights and responsibilities between the depositary bank and the payor bank, not to reduce the rights of the consumer against the payor bank. While a depositary bank may have a better ability that a paying bank to prevent certain kinds of fraudulent deposit items, the consumer must continue to have a remedy directly against his or her own bank for payment of any item not authorized by the consumer.

Conclusion

The Check 21 Act was adopted by Congress under the principle that enhanced efficiency could be introduced into the banking system in a way that protects consumers. The substitute check and the associated rights or recredit, warranty, and indemnity are supposed to provide this protection. The proposed rule, draft commentary, and draft model notices need significant changes and additions to fulfill Congress' goal that the introduction of substitute checks be good for both banks and consumers.

Very truly yours,

Gail Hillebrand
Senior Attorney
Consumers Union
West Coast Regional Office
1535 Mission St.
San Francisco, CA 94103
415-431-6747 (phone)
415-431-0906 (fax)
hillga@consumer.org

Consumer Federation of America
1424 16th Street, NW Suite 604
Washington, DC 20036

U.S. PIRG
218 D Street, SE
Washington, DC 20003

National Consumer Law Center
1001 Connecticut Avenue, N.W., Suite 510
Washington, DC 20036

Consumer Action
717 Market St. Suite 310
San Francisco, CA 94103

Attachment One: Suggested changes to model notices

C-5A--Substitute Check Policy Disclosure
Substitute Checks and Your Rights

Some or all of the checks that you receive with your account statement or by request may look different than the check you wrote. To make check processing easier, a federal law permits banks to replace original checks with "substitute checks." This notice describes substitute checks and the rights that you will have ~~when you receive~~ concerning substitute checks.

Where is My Original Check?

Under a new federal law effective October 28, 2004, your bank may not get your original check. The new law creates special kind of copy of your check, called a substitute check, that you can use just like you would use the original check. If you want a specific original check back, ask your bank for a substitute check. If you like getting all your original checks back, ask your bank to send substitute checks with your account statement. If you suffer a loss because you didn't get your original check back, you have a claim against your bank. You have other new rights which are described in this notice.

What Is a Substitute Check?

A substitute check is a copy of an original check that is the same as the original check for all purposes, including proving that you made a payment, if it includes an accurate copy of the front and back of the original check and contains the words: "This is a legal copy of your check. You can use it the same way you would use the original check." A substitute check that meets these requirements is generally subject to federal and state laws that apply to an original check. If you lose money because because a substitute check was charged to your account ~~you received a substitute check~~, you have the right to ~~file a claim for~~ an expedited refund.

Your Right To File a Claim for an Expedited Refund

Federal law gives you the right to file a claim for an expedited refund if you ~~receive a substitute check and~~ believe that all of the statements below are true—

(1) The substitute check was incorrectly charged to your account (for example, this may be true if we charged your account for the wrong amount or if we charged your account more than once for the same check);

(2) You lost money as a result of the substitute check charge to your account; and

(3) You need the original check or a better copy of the original check to demonstrate that we incorrectly charged your account (for example, this may be true if you think that we charged your account for the wrong amount and the substitute check does not clearly show the amount).

Expedited Refunds

To obtain an expedited refund, you must ~~send us~~ make a claim. You may make an oral claim, but we can require that you submit certain information in writing after you make your claim. We cannot charge you a fee for your claim. Federal law limits an expedited refund to the amount of your loss, up to the amount of the substitute check, plus interest if your account earns interest. You should be aware that you could be entitled to additional amounts under other state or federal law, including this law.

How To Make a Claim for an Expedited Refund

Please make your claim [by calling (phone number), by writing to us at (address), or by e-mailing us at (address)]. You must make your claim within 40 calendar days of the later of these two dates:

(1) The date that we delivered the account statement showing the charge that you are disputing, or

(2) The date on which we made the substitute check available to you.

If there is a good reason (such as a long trip or a hospital stay) that you cannot make your claim by the required day, we ~~will~~ must give you additional time.

` Your expedited refund claim must—

(1) Describe why you think the charge to your account was incorrect;

(2) Estimate how much money you have lost because of the substitute check charge;

(3) Explain why the substitute check is not sufficient to show whether or not the charge to your account was correct; and

(4) Provide us with a copy of the substitute check or give us information that will help us to identify the substitute check and investigate your claim (for example, the check number, ~~the name of the person to whom you wrote the check,~~ and the amount of the check).

Our Responsibilities for Handling Your Claim

We ~~will~~ must investigate your claim promptly. If we cannot show you that we correctly ~~conclude that we incorrectly~~ charged your account, we ~~will~~ must refund to your account the amount of your claim (up to the amount of the substitute check, plus interest if your account earns interest) within one business day of making that decision. If we ~~conclude~~ demonstrate that we correctly charged your account, we ~~will~~ must send you a notice that explains the reason for

our decision and includes either the original check or a better copy of the original check than the one you already received. If we have not made a decision on your claim within 10 business days after you submitted it, we ~~will~~ must refund the amount that we owe to your account, up to $2,500, plus interest, by that date. We will refund the remaining amount, if any, plus interest, to your account by the 45th calendar day after you submitted your claim.

If we refund your account, on the next business day we will send you a notice that tells you the amount of your refund and the date on which you may withdraw that amount. Normally, you may withdraw your refund on the business day after we make it. In limited cases, we may delay your ability to withdraw up to the first $2,500 of the refund until the earlier of these two dates: (1) The day after we determine that your claim is valid; or (2) the 45th calendar day after the day that you submitted your claim.

Reversal of Refund

We may reverse any refund that we have given you up to (time) if we later determine that the substitute check was correctly charged to your account. We also may reverse any interest we have paid you on that amount if your account earns interest. Within one business day after we reverse a refund, we ~~will~~ must send you the original check or a better copy of the original check than the one you previously received, explain to you why the substitute check was correctly charged to your account, and tell you the amount and date of the reversal.

Your Other Rights about the Substitute Check

You have the right to ask your bank for a substitute check. If a substitute check was used in processing your check, you also have a warranty right against your bank if the check was paid twice or was paid for the wrong amount. This new law also gives you rights if you are harmed because you can't get the original check.

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The Checks You Write May Clear Faster

Because of this change in how checks are processed, the checks you write may clear faster. Do not write any check unless the funds are already in your account when you write the check.

26. In appendix C, after model C-21 add new models C-22 through C-25 to read as follows:

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C-22--Expedited Recredit Claim, Full Refund Notice
Notice of Refund

~~We have determined that your claim that a substitute check was incorrectly charged to your account is valid.~~ Your claim for a credit is granted. We are refunding (amount) [of which (amount) represents accrued interest] to your account. You may withdraw these funds as of

(date). [This refund is the amount in excess of the $2,500 that we credited to your account on (date).] We can change our decision within ___ days.

If within (time period), we later determine that the substitute check was correctly charged to your account, we will reverse the refund by charging your account. We will notify you within one day of any such reversal unless that day is on a weekend or a federal holiday.

C-23--Expedited Recredit Claim, Partial Refund Notice
Notice of Partial Refund

In response to your claim that a substitute check was incorrectly charged to your account, we are refunding (amount) [of which (amount) represents accrued interest] to your account, pending the completion of our investigation of your claim. You may withdraw these funds as of (date). [~~Unless we determine that your claim is not valid, the~~ We must credit the remaining amount of your refund ~~will be credited~~ to your account no later than the 45th calendar day after you submitted your claim unless we demonstrate that the check was properly charged to your account.]

If within (time period), we later determine that the substitute check was correctly charged to your account, we will reverse the refund by charging your account. We will notify you within one day of any such reversal unless that day is on a weekend or a federal holiday.

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C-24--Expedited Recredit Claim, Denial Notice
Denial of Claim

We reviewed your claim that a substitute check was incorrectly charged to your account. We are denying your claim. As the enclosed [(original check) or (copy of the original check)] shows, the charge to your account of (amount) was proper because (reason, e.g. amount charged is the same or the signature is authentic).

[We have also enclosed a copy of the other information we used to make our decision.] [Upon your request, we will send you a copy of the other information that we used to make our decision. There is no fee for that information.]

C-25--Expedited Recredit Claim, Reversal Notice
Reversal of Refund

In response to your claim that a substitute check was incorrectly charged to your account, we provided a refund of (amount) by crediting your account on (date(s)). We now have determined that the substitute check was correctly charged to your account. We have reversed the refund. As the enclosed [(original check) or (copy of the original check)] shows, the charge to your account of (amount) was proper because (reason, e.g. amount charged is the same or the signature is authentic). As a result, we have reversed the refund to your account [plus interest we have paid you on that amount] by charging your account in the amount of (amount) on (date).

[We have also enclosed a copy of the other information we used to make our decision.] [Upon your request, we will send you a copy of the information we used to make our decision.]

Attachment Two: Descriptions of consumer organizations joining this letter

Consumers Union of U.S., Inc., is described in the footnote 1 to the comment letter.

The Consumer Federation of America is a non-profit association of 300 consumer groups, with a combined membership of more than 50 million people. CFA was founded in 1968 to advance the consumers/ interest through advocacy and education.

The U.S. Public Interest Research Group (U.S. PIRG) serves as the national lobbying office for state Public Interest Research Groups. PIRGs are non-profit, non-partisan consumer and government reform organizations active in 37 states.

The National Consumer Law Center (NCLC) is a Massachusetts non-profit corporation established in 1969. NCLC provides assistance to legal services attorneys, governmental agencies, and private attorneys in advancing the interests of their low-income and elderly clients in the area of consumer law.

Consumer Action is a statewide consumer education and advocacy organization serving California consumers since it was founded in San Francisco in 1971. Consumer Action serves consumers nationwide by advancing consumer rights, referring consumers to complaint-handling agencies and publishing multilingual educational materials. Consumer Action also advocates for consumers in the media and before lawmakers and annually conducts comparison surveys for consumers on credit cards, banking issues and telecommunications issues.