

December 19, 2011

Ms. Jennifer J. Johnson  
Secretary,  
Board of Governors  
Of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

RE: Docket No. R-1434  
RIN No. 7100 AD 84  
Regulation J, Collection of Checks and Other Items by Federal Reserve Banks and Funds  
Transfers Through Fedwire: Elimination of “As-Of Adjustments” and Other  
Clarifications.

Dear Ms. Johnson:

The American Bankers Association (ABA)<sup>1</sup> is pleased to submit comments on the Federal Reserve Board’s (Board) proposed changes to Regulation J to reflect the elimination of references to “as-of adjustments”, to clarify that a financial institution’s Administrative Reserve Bank is deemed to have accepted deposit of a check item even if the financial institution send the check directly to another Federal Reserve Bank, and to affirm that Regulation J continues to apply to Fedwire transfers even if it falls under the definition of “remittance transfer” under the Electronic Funds Act.

ABA supports the proposal to replace references to “as-of adjustments” in Regulation J to reflect changes proposed in the companion Request for Comment regarding Regulation D, as long as the Board provides detailed information regarding the associated errors that will allow financial institutions to reconcile the events.

ABA supports the proposal deeming a financial institution’s Administrative Reserve Bank to have accepted deposit of a check even if that check is sent to another Federal Reserve Bank.

ABA supports the affirmation that Regulation J continues to apply to Fedwire transfers, and ABA also supports further efforts to ensure that all wire transactions receive the same protection.

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<sup>1</sup> The American Bankers Association represents banks of all sizes and charters and is the voice for the nation’s \$13 trillion banking industry and its two million employees. The majority of ABA’s members are banks with less than \$165 in assets.

## Summary of the Proposed Rule

### Eliminate references to "as-of adjustments"

The Board of Governors requests comment on a proposal to update Regulation J that is related to the concurrent proposal to update Regulation D to eliminate references to "as-of adjustments." This proposed change would eliminate references to that term in Regulation J to ensure consistency with both regulations. Under the new rules, any compensation for errors would be made using direct compensation and not through adjusting future reserve balances.

In ABA's comments on the Regulation D proposal, the Association recommended that the Board require that specific information accompany any adjustments for errors that would allow financial institutions to reconcile the transaction.

At a minimum, the Board must provide the following information regarding direct compensation notices:

- Entry date and entry amount of the adjustment posted to a bank's Fed account.
- The starting and ending dates covered by this notice of direct compensation and the number of days used in calculating the dollar amount of the correction.
- The value of each transaction, including the original entry amount and any interest adjustment.
- The interest rate used in the direct compensation calculation.
- A description of the event triggering the erroneous entry amount.

This proposed change as applied to check processing could result in new direct compensation adjustments for banks if large encoding errors are identified. Currently, financial institutions adjust bank balances held at Federal Reserve Banks in future periods to reflect these errors and any accrued interest. The new direct compensation policy will result in actual funds transfers associated with each event. As paper-based instruments, checks have a very different processing profile than wire transfers. This includes the lack of immediate settlement and the greater potential for processing errors. Encoding errors during the initial capture process at the bank of first deposit can create a condition where a check payment is made for a dollar amount other than that intended by the issuer. As an example, a check that should have been paid in the amount of \$3,000 is actually processed in the amount of \$30,000.

It is not always immediately apparent that a check has paid for an incorrect dollar amount and therefore requires an adjustment. Our concern is that if the Board discontinues the use of 'as of adjustments' for checks, this could create significant direct compensation charges for banks that may have to be internalized or pursued with the bank of first deposit.

This is likely to create a burdensome new process for banks as the bank of first deposit and the paying bank must jointly review and reconcile the error. Further, the negative effect of direct compensation adjustments will increase when interest rates rise above the current historically low levels.

ABA recommends that the elimination of references to “as-of adjustments” be adopted with the understanding that the companion changes to Regulation D include the additional information regarding the errors to allow banks to reconcile accounts. Further, ABA recommends that the Board give careful scrutiny and ongoing review to instances where check encoding errors result in large direct compensation assessments.

#### Acceptance of Deposits of Items

This proposal would also amend the existing section of the Regulation J regarding the determination of rights and liabilities of parties that send and handle checks and other items sent to an FRB. The proposal would clarify that “handling” of an item by the initial sender’s Administrative Reserve Bank includes accepting the item for deposit.

This proposal would also amend Subpart A of Regulation J regarding the determination of rights and liabilities of parties that send and handle checks and other items sent to a Federal Reserve Bank that is not the financial institution’s Administrative Reserve Bank. The proposal would clarify that “handling” of an item by the initial sender’s Administrative Reserve Bank includes accepting the item for deposit. For purposes of determining rights and liabilities, the Administrative Reserve Bank is deemed to have accepted the deposit of the item even if the sender sends the item directly to another Reserve Bank. This proposal is being made due to the decline in processing of paper checks and the elimination of all Federal Reserve Bank paper check processing sites except for one.

Under the current rule the order of parties determined to have handled an item is:

1. The initial sender;
2. The initial sender’s Administrative Reserve Bank;
3. The Reserve Bank that receives the item from the initial sender (if different than the initial sender’s Administrative Reserve Bank); and
4. Another Reserve Bank, if any, that receives the item from a Reserve Bank.

Under the proposed rule, even if the second step has been skipped, the Administrative Reserve Bank still would be considered to have accepted the item for deposit.

The ABA does not object to this proposed rule change.

#### Application of Regulation J to “Remittance Transfers”

Finally, this proposal would change the application of Regulation J to clarify that the regulation would apply to “remittance transfers” as defined by the Electronic Funds Transfer Act (EFTA) to the extent that there are no inconsistencies between Regulation J and EFTA. This last change will ensure that Regulation J (and subsequently Article 4A of the UCC) would apply to all Fedwire funds transfers except where the EFTA would apply.

This proposal is being made because a provision in the Dodd-Frank Act (DFA) added a new section to the EFTA creating new requirements for sending remittance transfers to designated recipients in foreign countries. The DFA defines “remittance transfer” to include an electronic funds transfer requested by a consumer through a remittance provider regardless of whether that

remittance transfer is also an electronic funds transfer as defined in the EFTA. The result is that a Fedwire funds transfer could be considered a remittance transfer under the new section 919 of the EFTA, and not governed by Regulation J.

Problems may arise because the EFTA addresses disclosure and consumer protections but does not address the rights and liabilities of the parties to a Fedwire transaction as found in regulation J. The proposed rule change would clarify that Regulation J would apply to remittance transfers as defined by the EFTA to the extent that Regulation J and new section 919 of the EFTA are consistent.

The ABA supports this rule change to correct any possible unintended consequences of the DFA provision removing certain transactions from the protections of Regulation J. However, this change is not complete and would protect Fedwire transactions, but not other wire transactions.

The Clearing House operates the CHIPS wire system. It would be preferable for both wire operators to have similar protections under Regulation J. There has been some discussion as to whether The Clearing House can assert these protections themselves through their own operating rules. However, only CHIPS participants are subject to those operating rules and they would not apply to any third parties that may be affected. ABA believes that it would be best for all wire transactions to be subject to the same regulations and protections.

#### Effective Dates

The elimination of “as-of adjustments” should be made in conjunction with changes in Regulation D and made effective no earlier than Q1 2013.

The other changes will require banks to make changes to policies and procedures. Banks have already established their change management plans for 2012. Disrupting these plans will add to the expense of making not only these changes, but all of the other changes that must now be rescheduled. ABA recommends that these changes be made effective no earlier than Q1 2013.

ABA appreciates the opportunity comment on the Board’s proposal regarding Regulation J. If you have any questions about these comments, please contact the undersigned at (202)663-5147 or via email at [skenneally@aba.com](mailto:skenneally@aba.com).

Sincerely,



Stephen K. Kenneally  
Vice President  
Center for Regulatory Compliance