



July 13, 2010

Mr. Bill Brushwood  
Financial Management Service  
401 14<sup>th</sup> Street, SW  
Room 400A  
Washington, D.C. 20227

Re: Comment on Proposed Rules Regarding Federal Government Participation  
in the Automated Clearing House, Docket No. FISCAL-FMS-2009-0001

Dear Mr. Brushwood:

The Clearing House Association L.L.C.<sup>1</sup> ("The Clearing House") respectfully submits this comment letter in response to the notice of proposed rulemaking and request for comment published by the Financial Management Service ("FMS") regarding the regulations that govern the use of the Automated Clearing House ("ACH") system<sup>2</sup> by federal agencies (the "Proposed Rule").

The Clearing House greatly appreciates the effort by FMS to ensure that requirements applicable to ACH payments remain consistent and to add clarity to the rules concerning federal payments that are addressed in the Proposed Rule. The Clearing House also appreciates the opportunity to comment on the Proposed Rule and welcomes future dialogue on these issues. Given the scope and potential impact to FMS, as well as to ACH participants, The Clearing House would strongly request an ongoing forum to discuss technical, operational, and client readiness issues to minimize disruptions to impacted parties.

As further explained below, The Clearing House has several comments to the Proposed Rule, which include (I) the adoption of the International ACH Transaction ("IAT") Standard Entry Class Code, particularly as it relates to (a) the classification of IATs and (b) correcting

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<sup>1</sup> Established in 1853, The Clearing House is the nation's oldest payments company and banking association. The Clearing House is owned by 21 of the largest commercial banks in America, which employ 1.4 million people domestically and hold more than half of all U.S. deposits. The Payments Company within The Clearing House clears and settles approximately \$2 trillion daily, representing nearly half of the U.S. volume of ACH, wire and check image transactions. The Clearing House Association is a nonpartisan advocacy organization within The Clearing House that represents, through regulatory comment letters, amicus briefs and white papers, the interests of 13 of its owner banks on a variety of systemically important bank policy issues.

<sup>2</sup> 31 C.F.R. Part 210.

errors in IATs; (II) ensuring efficiency in the reclamation process; and (III) changes affecting the Payment Transactions Integrity Act of 2008 requirements that involve prepaid and stored value cards, particularly as they relate to (a) the exceptions to the “in the name of recipient” requirement as applied to stored value and prepaid card accounts and (b) ensuring that funds reach the unbanked and underbanked. Each comment is described in detail below.

## **I. International ACH Transactions**

### **a. Classification of IATs**

The Proposed Rule recommends adoption of recently implemented NACHA rules that would require Originating Depository Financial Institutions (“ODFIs”) to identify all international payment transactions using a new “Standard Entry Class Code.” This Standard Entry Class Code categorizes international payments based on the geographical location of the financial institutions or money transmitting businesses involved in the transaction, instead of the location of the originator or receiver.

However, in the preamble to the Proposed Rule, FMS sets forth its expectation that federal agencies may identify transactions as IAT even though funds do not ultimately leave the U.S. Specifically, FMS anticipates that federal agencies will categorize as IAT transactions “any payment to an individual or entity with an address outside the territorial jurisdiction of the U.S.” rather than categorizing such transactions based on the location of the financial institution involved in the transaction.<sup>3</sup> Basing IAT classification on the address of the payee rather than on the location of the financial institution involved in the transaction may result in payments being incorrectly classified as IATs.

The Clearing House has serious concerns about the possibility that federal agencies may be permitted to incorrectly classify ACH payments as IAT payments because this would result in a shift of the government’s compliance costs to receiving depository financial institutions (“RDFIs”), which would be overly burdensome on and unfair to RDFIs. Federal agencies have an obligation to undertake the same level of responsibility and due diligence as other participants in the ACH system.

If federal agencies fail to undertake the same level of due diligence as private participants, it would amount to a substantial shift of compliance costs and burdens from the federal agencies to RDFIs. Specifically, federal agencies would be avoiding their obligations to perform the necessary due diligence to correctly code ACH transactions and RDFIs would, in turn, be forced to process a large number of ACH payments as IATs unnecessarily and at a great cost and burden to the RDFI.

Notably, as processors of ACH transactions, RDFIs already have their own compliance obligations and costs. Generally speaking, financial institutions staff and fund their ACH and IAT processing operations proportionate to projected volume of various types of ACH transactions and the complexities of processing those ACH transactions. Processing IAT transactions is more labor intensive than processing other types of ACH transactions. The

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<sup>3</sup> 75 Fed. Reg. 27241 (May 14, 2010).

addition of a potentially large number of ACH transactions being processed unnecessarily as IAT transactions would put a strain on these departments and ultimately will require financial institutions to devote greater resources to their IAT processing operations.

In addition, processing a large number of unnecessary IAT transactions will be overly burdensome to financial institutions because IATs are generally viewed as having heightened risk and therefore require increased monitoring and controls. The strain of applying additional monitoring and controls to large numbers of ACH transactions unnecessarily coded as IAT transactions could impact processing time, which will delay payments to recipients. Delayed payments to recipients could, in turn, cause beneficiaries to contact the federal agency that initiated the payment and put a strain on that agency's customer service/call center resources. Accordingly, The Clearing House believes that federal agencies performing the necessary due diligence to correctly code a transaction at the point of origination (and thus avoid potential delay in transaction processing) would prevent a strain on an agency's customer service/call center resources on the back end.

Further, it is an unfair appropriation of RDFIs' resources to require them to bear additional financial and compliance burdens, particularly when such costs and burdens result directly from federal agencies' lack of performance of their own obligations. Thus, this cost should be borne directly by federal agencies as ACH network participants in the same manner as the cost is borne by private sector network participants originating ACH entries.

Finally, ensuring efficiency throughout the ACH system and the appropriate use of resources by the financial institutions processing ACH transactions requires that payments are accurately identified and are transmitted with the accompanying information appropriate to transaction type and risk. The federal agency initiating the payment is in the best position to accurately classify the payment as IAT or non-IAT, and should be required to do so. Having federal agencies knowingly transmit incorrectly coded IAT payments could have an impact on the integrity of the payments system, and shifts to financial institutions the costs of processing unnecessary IAT transactions to save federal agencies the burden of investigating whether a particular transaction should be coded as an IAT transaction.

#### **b. Correcting Errors in IATs**

The Clearing House seeks to establish a process to correct errors in IATs by directly contacting the federal agency that initiated the transaction. The Clearing House notes that when an IAT includes incorrect information, the transaction is likely to be delayed due to the time it takes the financial institution to track down correct information. In fact, in some cases the financial institution may not be able to process the transaction at all if it is unable to obtain correct information.

Accordingly, The Clearing House recommends that the federal agency that initiates an IAT payment provide the RDFI with the name and telephone number of a person within the agency that the RDFI may contact in the event that an IAT includes incorrect associated information. This contact information should be provided electronically.

## **II. Reclamations**

As drafted, the Proposed Rule would provide for automated reclamation by the federal government. Specifically, the Proposed Rule would amend 31 C.F.R. §210.10 to provide that, effective January 1, 2012, an RDFI would be liable to the federal government for the full amount of all benefit payments received by the RDFI from an agency within 45 days after the death or legal incapacity of the recipient or death of the beneficiary (the “45-day Amount”). In this reclamation process, FMS may automatically debit an RDFI’s reserve account for the 45-day Amount following 30 days advance notice of the debit (“Debit Notice”), thereby creating a “more streamlined process with reduced processing, paperwork and postage.”<sup>4</sup> In the alternative, an RDFI may avoid the automatic debit by returning the 45-day Amount following the Debit Notice and during the 30 day Debit Notice period.<sup>5</sup>

The Clearing House believes that there are a number of additional measures that should be undertaken to ensure that the automated reclamations process functions smoothly and efficiently. First, The Clearing House recommends that RDFIs should be provided with notification from the applicable government agency regarding the death or legal incapacity of the recipient or death of the beneficiary of a recipient as early as possible. Second, The Clearing House urges that the notice be in electronic format and presented in plain English so that the RDFI can make the necessary adjustments as quickly as possible. Third, The Clearing House recommends that the notice contain adequate information to enable the RDFI to identify and understand the transaction, such as identifying information for the deceased and the type of benefits that are subject to reclamation.

To this end, The Clearing House encourages FMS to consider utilizing the Centralized Reclamation Application that is currently being tested by the Federal Reserve Banks as the mechanism for providing RDFIs with electronic reclamation notice and automated debit information.

## **III. Payment Transactions Integrity Act of 2008 / Prepaid Debit and Stored Value Card Accounts**

The Clearing House notes that in many cases it is not altogether clear whether and to what extent certain federal regulations apply to stored value cards and prepaid card accounts. Accordingly, The Clearing House very much appreciates FMS’ efforts in the Proposed Rule to clarify its rules regarding stored value and prepaid card accounts. In addition, The Clearing House has two comments on FMS’ proposal specifically as it relates to stored value and prepaid card accounts, as described below.

### **a. Stored Value and Prepaid Cards as Regulation E Accounts**

The Proposed Rule would amend 31 C.F.R. § 210.5 to provide for three additional exceptions to the “in the name of recipient” requirement, which requires that an account at a

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<sup>4</sup> 75 Fed. Reg. 27242, 27247.

<sup>5</sup> *Id.* Under either alternative, the Proposed Rule change would affect only the procedure used to process a reclamation, and not the amount of the RDFI’s liability.

financial institution receiving federal benefit payments (other than a vendor payment) be in the name of the recipient. One of the three proposed exceptions to the “in the name of the recipient” requirement covers prepaid and stored value card accounts. Specifically, under the Proposed Rule, in order to be eligible for the exception to the “in the name of the recipient” requirement, prepaid debit and stored value card accounts would need to, among other things, constitute an “account” as defined in 12 C.F.R. § 205.2(b) such that the consumer protections of Regulation E apply to the cardholder.

The Clearing House has serious concerns about tying this exception to the “in the name of the recipient” requirement to Regulation E because not all stored value and prepaid card accounts through which federal benefit payments may be made would satisfy Regulation E’s technical definition of “account.” Currently, the definition of “account” under Regulation E applies only to demand deposit, savings and other consumer asset accounts. In 2006, the Board of Governors of the Federal Reserve System (the “Board”) expressly modified the Regulation E definition of “account” to include “payroll card accounts,” which means an account established through an employer that is funded by electronic transfers of the consumer’s wages, salary or other employee compensation. In promulgating the final rule amending Regulation E to include payroll card accounts within the definition of “account,” the Board expressly declined to extend the definition of “account” to gift cards and to general spend prepaid cards, deeming there to be “little benefit” to consumers of full Regulation E protection for such products while the costs to the card-issuing financial institutions of such compliance might be “substantial.”<sup>6</sup> Thus, requiring that the prepaid and stored value card exception to the “in the name of the recipient” requirement apply only where the prepaid or stored value card account constitutes an “account” under Regulation E would require a much broader application of Regulation E than is currently required by the Board.

The Clearing House does not believe that FMS should tie the prepaid and stored value card exception to the “in the name of the recipient” requirement to the definition of “account” under Regulation E because (1) such a tie is not necessary to accomplish the objective of ensuring that the applicable agency’s payments are associated with the appropriate beneficiary (which can be accomplished simply by requiring that the card-issuing financial institution associate the name of the beneficiary with the allocable portion of funds received from the agency), (2) as noted above, requiring that prepaid and stored value card accounts fall within the Regulation E’s definition of “account” would require a broader reading of Regulation E than the Board has required, and (3) as the Board noted in its 2006 final rule amendment Regulation E to include coverage of payroll card accounts, requiring full Regulation E protections for such prepaid and stored value cards would provide little benefit to consumers (especially since stored value and prepaid cards already provide consumers with many of the protections set forth in Regulation E), but would require card issuers to incur substantial costs (such as having to send out periodic statements, annual error and dispute resolution notices, and the like). As an alternative approach, The Clearing House urges FMS to abandon the references to Regulation E and instead allow for the “in the name of the recipient” exception to be applied to all stored value and prepaid card products that comply with applicable law.

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<sup>6</sup> 71 Fed. Reg. 51437, 51441 (August 30, 2006).

Regulation E requires financial institutions to undertake a number of disclosure and compliance obligations that would be burdensome as applied to stored value and prepaid cards and that, as noted above, are unrelated to the proposed exception to the “in the name of the recipient” requirement. Furthermore, financial institutions have not historically been required to undertake such disclosure and compliance obligations with respect to stored value and prepaid cards. Accordingly, if FMS adheres to its proposal to allow the prepaid and stored value card exception to the “in the name of the recipient” requirement only for prepaid and stored value card accounts that meet the definition and requirements of an “account” under Regulation E, The Clearing House strongly recommends a lengthy phase-in time for the exception, as it would require financial institutions to make substantial modifications to procedures, systems and controls in order to satisfy the requirements of Regulation E for prepaid and stored value card accounts.

#### **b. Unbanked/Underbanked Use of Stored Value and Prepaid Cards**

The Proposed Rule sets forth FMS’ belief that the “in the name of the recipient” requirement may be impeding the use of prepaid card programs beneficial to unbanked and underbanked populations, and that account structures underlying prepaid and stored value cards can be set up to ensure the recipient receives and has control of payments, even if the cardholder’s name is not on the account title in which the funds are held.

Accordingly, FMS specifically solicited comments on whether to add the italicized language as follows:

“an ACH credit entry representing a Federal payment other than a vendor payment shall be deposited into a deposit account held by a financial institution *and directly accessible by the recipient.*”<sup>7</sup>

The Clearing House agrees with the objective of ensuring that the ultimate beneficiary receives the funds to which they are entitled irrespective of their unbanked/underbanked status. However, The Clearing House is concerned that the proposed language is too limiting because it requires that the deposit account itself be accessible to the recipient, which may thwart the ability of the rule to extend to unbanked populations. Instead, we recommend that the beneficiary should have access to the *funds* themselves rather than to the account. Thus, we recommend revising the proposed language as shown in bold:

“an ACH credit entry representing a Federal payment other than a vendor payment shall be deposited into a deposit account held by a financial institution *and that such funds be accessible by the recipient.*”

#### **IV. Customer Contact Information**

In the Proposed Rule, FMS seeks to amend 31 C.F.R. § 210.11(b)(3)(i) to require financial institutions to provide account owner phone numbers along with the information institutions are required to provide in connection with the investigation or recovery of improper federal

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<sup>7</sup> 75 Fed. Reg. 27245.

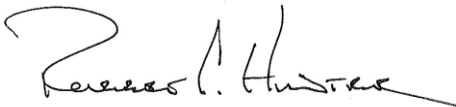
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payments. Regarding customer phone numbers, we note that there is a major shift in consumer preference from traditional land line telephone technology to mobile technology. Unfortunately, consumers may not always remember to notify their bank of changes to their phone numbers when they transition from land to mobile technology or change mobile carriers. Accordingly, the final rule should clarify that a bank is only required to provide the telephone information that it has received from the customer as reflected in bank records.

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Thank you for the opportunity to comment on the Proposed Rule. If you have any questions or wish to discuss The Clearing House's comment, please do not hesitate to contact me at 336.769.5314.

Yours very truly,

A handwritten signature in black ink, appearing to read "Robert C. Hunter". The signature is fluid and cursive, with a long horizontal stroke at the end.

Robert C. Hunter  
Senior Vice President & Senior Counsel