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September 8, 2021

Via Electronic Submission

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street Constitution Avenue NW
Washington, DC 20551

RE: Docket No. R-1750; RIN 7100-AG16 – Proposed Rule and Comment Request for Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire

Dear Ms. Misback:

The Independent Community Bankers of America (“ICBA”)¹ appreciates the opportunity to provide comments on the Board of Governors of the Federal Reserve System’s (“Board”) proposed rulemaking on Regulation J (Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire). ICBA is generally supportive of this proposal and believes the contemplated changes will increase consistency in regulation between the payment systems. However, ICBA emphasizes the importance and value of further clarity in some of the proposed changes and additions to reduce the potential for confusion in the market.

Background

Today, subpart A of Regulation J provides the legal framework for banks to collect checks and to settle balances through the Federal Reserve System. Subpart B of Regulation J sets forth the rules applicable to funds transfers handled by Reserve Banks over the Fedwire Funds Service. The Board is now proposing a new subpart C to provide a comprehensive set of rules for the forthcoming arrival of the FedNow

¹ The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than \$5 trillion in assets, over \$4.4 trillion in deposits, and more than \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation, and fueling their customers’ dreams in communities throughout America. For more information, visit ICBA’s website at www.icba.org.

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Service, a new interbank 24x7x365 real-time gross settlement service with integrated functionality.² As it works to operationalize the FedNow Service, the Board is assessing whether existing regulations are sufficiently adequate to facilitate the FedNow Service or if additional regulations must be promulgated in preparation.

Specifically, the Board proposes that subpart C would: (1) specify the terms and conditions under which Reserve Banks will process funds transfers over the FedNow Service, (2) grant the Reserve Banks authority to issue an operating circular for the FedNow Service, (3) include a requirement for a FedNow participant that is the beneficiary's bank to make funds available to the beneficiary immediately after it has accepted the payment order over the service, and (4) expand and clarify the applicability of the Uniform Commercial Code ("UCC") Article 4A to all transfers over the FedNow Service.³

Concurrently, the Board proposes a complementary change and clarification to subpart B to reflect that Reserve Banks will be operating a second funds transfer service in addition to the Fedwire Funds Service. The Board is soliciting comment on both these proposed changes and proposed technical corrections to subpart A of Regulation J.

ICBA Summary

ICBA generally supports the Board's proposal to establish a new subpart C in Regulation J to govern funds transfers over the FedNow Service and other revisions, which would create uniformity in the regulations associated with other payment systems. The Board is also proposing changes and clarifications to subpart B, governing the Fedwire Funds Service, and recommending technical corrections to subpart A, governing the check service. ICBA believes these additional changes are reasonable.

Highlights from the comment letter are noted below:

- ICBA emphasizes the importance of understanding the proposed interplay between UCC 4A and the Electronic Fund Transfer Act ("EFTA") and requests the Board offers additional guidance and clarity in their application to the FedNow Service.
- ICBA recommends that any definition of "immediately," (i.e., the requirement that a FedNow participant make funds available to the beneficiary after it has accepted the payment order over

² Board of Governors of the Federal Reserve System, Press Release, "Federal Reserve announces plan to develop a new round-the-clock real-time payment and settlement service to support faster payments," Aug 5, 2019.

³ UCC Article 4A provides rules governing the rights and responsibilities of the parties to funds transfers. The rights and responsibilities covered in UCC Article 4A include those with respect to the receipt, acceptance or rejection, and execution of a payment order and settlement of a payment obligation; liability for the late, erroneous, or improper execution of funds transfers; the risks of loss associated with an unauthorized payment order; the obligation to pay for and the right to receive payment for a payment order; and the effect of payment by funds transfer on any underlying obligation between an originator and a beneficiary of a funds transfer.

the FedNow Service), should be established from an evidence-based study of the FedNow pilot phase. Setting parameters in the absence of data may lead to unintended consequences.

- ICBA appreciates the proposed feature of the FedNow Service where a beneficiary's bank may notify its Reserve Bank that it requires additional time to determine whether to accept the payment order when there is reasonable cause to believe that the beneficiary is not entitled or permitted to receive payment. These circumstances may arise as in the case of an unauthorized payment or a disruption in the system.
- ICBA applauds the Board's commitment to making real-time payments secure, accessible, and ubiquitous. We urge the FedNow team to continue working with The Clearing House to make achieving instant payments interoperability a priority.
- Further, ICBA requests clarification in the definitions of other noted terms and conditions related to overdraft fees and cash items.

ICBA Comments

ICBA remains a strong supporter of the Federal Reserve's leadership role in payments. ICBA is optimistic the FedNow Service will provide a foundation for a robust and secure instant payments system that will spur innovation. Importantly, FedNow will offer choice and competition in the market for community banks and their customers. The addition of a universally accessible and secure instant payments service is essential for community banks to continue to meet the evolving needs of their customers.

ICBA recognizes the need for appropriate regulation to support the launch of FedNow. To that end, ICBA agrees with the Board in incorporating subpart C to address the new payment service, where many of the concepts embodied in subpart C are similar to those currently in subpart B of Regulation J. This approach will further increase consistency between subparts within Regulation J.

Elsewhere, in subparts B and C, the Board offers clarifications and defines gaps in terminologies to align the rights and obligations of the various participants with the different payment systems. While these modifications are welcomed, ICBA stresses the need to provide additional clarity, especially in areas of the proposal that are ambiguous.

Please see additional comments and concerns:

Uniform Commercial Code Article 4A (UCC 4A) and Electronic Funds Transfer Act (EFTA)

UCC 4A, which has been adopted in all 50 states, provides comprehensive rules governing the rights and responsibilities of the parties to funds transfers. While ICBA agrees the Board's contemplation of applying UCC 4A is reasonable, we are concerned by the application of UCC 4A by the Board to all transfers over the FedNow Service.

Today, UCC is applicable only to specific business-to-business funds transfers. In incorporating UCC 4A into subpart C, the Board is proposing to apply UCC 4A through FedNow to domestic consumer

transfers, an area traditionally governed through EFTA and Regulation E. ICBA's primary concern is that the application of UCC 4A to domestic consumer payments creates ambiguity and uncertainty, particularly where there are inconsistencies between UCC 4A and EFTA.

The proposal does not explain these inconsistencies between the regulatory regimes. ICBA cautions the Board to carefully evaluate the interplay between UCC 4A and EFTA. Specifically, clarity is needed in areas that include liability considerations for unauthorized transfers and timing of notifications of handling questionable payments. Notably, the proposed amendments incorporating UCC 4A do not govern similar services by private-sector providers in the same way.⁴ A consistent approach between the private sector and public sector rules would alleviate marketplace confusion.

ICBA encourages the Board to convene a group of stakeholders to achieve consensus on the appropriate legal and operational framework to address these concerns. Relatedly, ICBA urges the Board to provide more clarity to community banks that offer the FedNow Service, including relevant disclosure requirements, security procedures, and operational guidance.

Alongside the expansion of UCC 4A to FedNow Services, the Board recommends replacing the currently incorporated 1989 version with the more recent 2012 version.⁵ This approach seems reasonable given that the private sector real-time solution is also leveraging the latest version. To that end, ICBA welcomes Federal Reserve collaboration with The Clearing House to establish uniformity of rules and regulations between the private and public sector real-time payment solutions in the path to attaining interoperability and to ease community bank implementation supporting both networks.

Defining the Term "Immediately"

As the Board states, instantaneous transactions permit individuals and businesses to send and receive payments at any time, any day of the year, and within seconds. With this expectation, one proposed aspect of the FedNow Service is that banks will be required to make funds associated with individual instant payments available to their end-user customers "immediately" after receiving notification from the service that an instant payment had settled. Although it may be prudent for the Board to eventually define the term "immediately," ICBA urges that any specification of parameters should follow robust testing of end-to-end transfers and be based on data collected over the FedNow Service.

ICBA member banks are committed to making funds available as soon as possible. However, ICBA is firmly against mandating any timeframes prematurely that threaten to leave community banks at a disadvantage from any asymmetry of capabilities and resources. The downstream implications, with numerous participants in the chain, whether core processors, digital banking, other technology solution providers, and/or correspondent banks may have varying impacts in transaction durations. Therefore,

⁴ 86 FR 31376. The private sector applies UCCA 4A to business transactions and consumer transactions to EFTA and Regulation E.

⁵ With respect to the 2012 version, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, those statutory changes brought certain non-consumer remittance related funds transfers under the scope of the EFTA.

ICBA recommends that any introduction of a minimum posting time should happen following the FedNow pilot test phase to enable richer evaluation and establish a reasonable payment delivery timeframe.

Further, the Board states that the proposed subpart C grants each Federal Reserve Bank authority to issue an operating circular for the FedNow Funds Service prescribing specific terms and conditions for processing payment orders.⁶ ICBA believes this approach will provide an appropriate degree of flexibility for the Reserve Banks to expedite updates and changes as the infrastructure evolves, rather than requiring an amendment at the Regulation J level. However, it is critical that operating circulars maintain consistency in requirements, language, and terminology across the Federal Reserve System to avoid confusion in the market. Additionally, ICBA encourages the Board to solicit industry comments on operating circular updates related to FedNow operations.

Additional time to determine to accept a payment order

The proposed regulation would permit a FedNow participant that is a beneficiary's bank to notify its Reserve Bank that it requires additional time to determine whether to accept a payment order over the FedNow Service because it has reasonable cause to believe that the beneficiary is not entitled or permitted to receive payment. ICBA supports the option to provide banks with additional time to review accounts as circumstances may warrant. For instance, requirements under the Bank Secrecy Act might require a bank to conduct additional due diligence before accepting payment on behalf of its customer. Other examples that might necessitate further investigation include downtime due to system disruption or technical malfunction, suspected fraudulent activity like identity theft, or payment to a deceased party. There must be a balance between speed and a risk-based approach. Furthermore, ICBA emphasizes community banks cannot be required to review transactions beyond a bank's legal requirement to do so and its risk-based fraud and compliance processes.

Interoperability

The Federal Reserve acknowledged stakeholder feedback on the importance of interoperability to help advance the nationwide use of instant payments.⁷ ICBA agrees that interoperability is an essential step in driving instant payments adoption and achieving ubiquity. As in past comments,⁸ ICBA strongly urges the Federal Reserve and The Clearing House to prioritize collaboration to attain interoperability. Although the public and private sector operators should aim for interoperability as soon as possible, the Federal Reserve should not delay progress in bringing FedNow to market as the path to interoperability

⁶ p. 33 "Each Federal Reserve Bank shall issue an Operating Circular consistent with this subpart that governs the details of its funds-transfer operations in connection with the FedNow Service and other matters it deems appropriate"

⁷ FedNow Community Town Hall, May 4, 2020: <https://www.frbervices.org/financial-services/fednow/community/news/050721-may-4-town-hall.html>.

⁸ See Phillips, Deborah, "[Docket Number: OP-1670] Service Details on Federal Reserve Actions to Support Interbank Settlement of Instant Federal Reserve Actions to Support Interbank Settlement of Faster Payments," Sept. 10, 2020: https://www.icba.org/docs/default-source/icba/advocacy-documents/letters-to-regulators/icba-fednow-comment-letter.pdf?sfvrsn=92823917_0.

is explored. To the extent possible, ICBA also encourages the use of consistent business practices between the private and public sector real-time payments networks to ease community bank implementation processes. This would help create a more seamless end-user experience and reduce confusion in the marketplace.

Other Comments

ICBA recommends that the Board offer further clarity related to the following areas:

- **Overdraft charges** – Section 210.43 states that the Federal Reserve allows for overdraft charges for accounts without sufficient funds. Without more concrete information and the absence of settlement controls offered by the Federal Reserve, ICBA member banks expressed concern with its potential implications. As an example, if a correspondent bank incurs an overdraft charge for one of its customer' banks and the sender bank passes on the charge (due to a lack of front-end controls or other system problems), unwittingly, it could inadvertently cause a consumer issue.
- **Conflicting definitions related to subpart A** – Section 210.2 notes that “*Cash item* does not include a returned check;” subsequently, the latter is defined as “*Returned check* means a cash item returned by a paying bank.” ICBA requests the Board remove ambiguity in the language and provide more specific guidance to community banks.

ICBA appreciates the opportunity to provide comments in response to this request. The FedNow Service will be an essential addition to the U.S. financial system, and ICBA strongly supports the Board's efforts to accelerate its implementation. If you have any questions, please do not hesitate to contact me at Nasreen.Quibria@icba.org or (202) 659-8111.

Sincerely,

/s/

Nasreen Quibria
Vice President, Emerging Payments and Technology Policy