April 3, 2023

Via Electronic Delivery

Department of the Treasury
Bureau of the Fiscal Service

Re: Docket FISCAL– 2021–0001; Indorsement and Payment of Checks Drawn on the United States Treasury; RIN 1530–AA22

Ladies and Gentlemen:

The Clearing House Association L.L.C. ("TCH")[1] and the Bank Policy Institute ("BPI")[2] respectfully submit this comment letter to the Bureau of the Fiscal Service of the Department of the Treasury ("Treasury") in response to Treasury's request for comment on a proposal to modify its regulations governing the payment of checks drawn on Treasury ("Treasury Check Regulation").[3]

I. Introduction

The proposal would require all financial institutions to use the Treasury Check Verification System ("TCVS") in an effort to prevent checks drawn on Treasury from being negotiated after cancellation, which is known as "payment over cancellation" (or "POC"). The proposed approach raises significant issues for

[1] The Clearing House Association L.L.C., the country's oldest banking trade association, is a nonpartisan organization that provides informed advocacy and thought leadership on critical payments-related issues. Its sister company, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States, clearing and settling more than $2 trillion each day, including an Image Exchange Network that allows financial institutions to exchange check images in the most efficient, cost-effective way. It also publishes and maintains the ECCHO rules that underpin private-sector exchanges of check images among financial institutions of all types and sizes. See The Clearing House's website at www.theclearinghouse.org for more information.

[2] The Bank Policy Institute is a nonpartisan public policy, research, and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

[3] Indorsement and Payment of Checks Drawn on the United States Treasury, 88 Fed. Reg. 6674 (proposed Feb. 1, 2023) (to be codified at 31 C.F.R. pt. 240).

financial institutions of all sizes. In particular, it would require the implementation of systems and processes unique to Treasury checks for all deposit channels a financial institution offers to its customers. The costs to implement such systems and processes would be significant. Further, in some cases, the changes required to prevent Treasury checks from being deposited and presented for payment might be impractical or impossible. For these reasons, TCH and BPI strongly believe that use of TCVS should remain optional. At the same time, we recognize Treasury's interest in reducing POCs. In this letter, we propose an alternative solution that would achieve Treasury's aims.

A. Overview of the Proposal

The proposal would require financial institutions to use TCVS, or another similar authorized system, to verify that Treasury checks are authentic and valid. The proposal would also make conforming amendments to the Treasury Check Regulation, including by adding certain new definitions. In addition, the proposal would modify the reasons that a Federal Reserve Bank must decline payment of a Treasury check to include prior cancellation of the check.

1. Requirement to Use TCVS

The Treasury Check Regulation currently includes a presentment guarantee that the financial institution presenting a check to Treasury for payment, as well as prior indorsers, has made all "reasonable efforts" to ensure that the check is an authentic Treasury check and not a counterfeit check.[4] Currently, however, financial institutions do not have an obligation to ensure that a Treasury check has not been canceled. As Treasury explains, "the current definition of 'reasonable efforts' focuses on the watermark and/or other security features of a security check, to ensure that the Treasury check is authentic and not counterfeit."[5] The proposal would amend the definition of "reasonable efforts" to also include verifying a Treasury check's validity using TCVS (when the system is available) to ensure that the check has not been canceled.

The proposal would make a corresponding change to the Treasury Check Regulation to add a presentment guarantee that a financial institution presenting the check for payment (and prior indorsers) "made all reasonable efforts to ensure that a check is both an authentic Treasury check (i.e., it is not a counterfeit check) and a valid Treasury check (i.e., it has not been previously negotiated or canceled)."[6]

[4] 31 C.F.R. § 240.4(d).

[5] 88 Fed. Reg. at 6675.

[6] *Id.* at 6678 (to be codified at 31 C.F.R. § 240.4(d)). If there is a breach of the presentment guarantee, Treasury has the right to reclaim the amount of the check from any guarantor for one year from the date the check is processed for payment by a Federal Reserve processing center. 31 C.F.R. § 240.8(a)(1). This reclamation period is extended by 180 days if a timely claim under 31 U.S.C. § 3702 is presented to the certifying agency. *Id*. at § 240.8(a)(2).

Further, the proposal would add definitions for the terms "validity or valid check,"[7] "cancellation or canceled,"[8] and "stop payment"[9] to the Treasury Check Regulation.

2. Processing of Checks

The proposal would add a new, fourth reason that a Federal Reserve Bank must refuse to pay a Treasury check. Specifically, with the change, a Federal Reserve Bank must decline to pay a Treasury check if it has been notified by Treasury that the check is not valid (i.e., counterfeit, previously negotiated, or canceled).[10]

3. Effective Date

In the supplemental information accompanying the proposal, Treasury acknowledges that "currently TCVS has a one-day lag" but that it will implement changes to enhance TCVS and allow for same-day verification beginning by mid-2023.[11] Treasury indicates it will provide at least 30 days' notice of the date that enhanced TCVS will become available for use and the date financial institutions will be required to use TCVS "when negotiating a Treasury check if [they are] to avoid liability for accepting a Treasury check that has been canceled."[12]

II. Discussion

The proposal assumes that depositary banks[13] can implement use of TCVS for all Treasury checks they accept across all their deposit channels and can make near-real-time decisions about whether to accept a Treasury check from a customer for deposit and send it for forward collection. This is inconsistent with the practical realities of many banks' deposit practices. Financial institutions typically accept checks for deposit from their customers and then send the checks for forward collection and presentment to paying banks. They may conduct additional review of the deposits as part of their back-office processes, but this is done to place risk-based holds on customer funds, consistent with Regulation CC, while the checks are in the process of being cleared and either paid or returned by paying banks. Depositary banks

[7] "Validity or valid check" would be defined as "an authentic Treasury check that is a payable instrument and has not been previously negotiated or canceled." 88 Fed. Reg. at 6677 (to be codified at 31 C.F.R. § 240.2).

[8] "Cancellation or canceled" would be defined as "a Treasury check that is no longer a valid instrument, due to the one-year limitation on negotiability and payment described in § 240.5(a), or the placement of a stop payment on the check by Treasury or the certifying agency." *Id.* (to be codified at 31 C.F.R. § 240.2).

[9] "Stop payment" would be defined to mean "that Treasury or a certifying agency has indicated that a Treasury check should not be paid and instead should be canceled. A stop payment could be placed on a Treasury check for reasons including that the check was reported lost or stolen; the check was determined to have been issued improperly; the payee was deceased prior to the issuance of the check; or any other allowable reason." *Id.* at 6678 (to be codified at 31 C.F.R. § 240.2).

[10] *Id.* at 6679 (to be codified at 31 C.F.R. § 240.12(a)(1)(iv)).

[11] *Id.* at 6674.

[12] *Id.*

[13] For simplicity, this letter uses terms like "depositary bank," "presenting bank," and "bank of first deposit" even though other types of financial institutions, such as credit unions, would be subject to Treasury's proposal. These terms are meant to include all varieties of depository institutions.

do not ordinarily stop the forward-collection process or have any systematic capability to do so. The proposal to require a depositary bank to make a real-time decision to reject a Treasury check from being deposited by a customer and sent forward for collection —or face liability—would thus be a significant departure from current practices and would likely be impractical for any financial institution to implement.

TCH and BPI recognize Treasury's concerns regarding the $98 million in losses resulting from POCs each year. We also support the effort to enhance TCVS as a general matter. The proposal states that TCVS "may eventually allow for the optional verification of other check information, such as the payee name and ZIP code."[14] We strongly support such enhancements, which would help reduce so-called "check washing" fraud, which has become a significant issue for the banking industry, and therefore encourage Treasury to implement them as expeditiously as possible. In fact, TCH and BPI believe these improvements should be made concurrently with the update to TCVS to capture information on canceled Treasury checks rather than as a future enhancement to TCVS, which would require financial institutions to undergo a second, subsequent integration effort, even if this would delay implementation of the enhanced TCVS by some period.

In addition, we agree with the proposal to require the Federal Reserve Banks to refuse to pay canceled Treasury checks.[15] To this end, we encourage Treasury to provide the Federal Reserve Banks with up-to-date information about the validity of Treasury checks to prevent improper payments.[16] If Treasury is able to provide information about canceled checks to financial institutions through TCVS, it should also be able to provide the same information to the Federal Reserve Banks so they can timely return the checks if the checks have been canceled by the government. Moreover, we recommend that Treasury require the Federal Reserve Banks to return the canceled checks expeditiously so they are promptly received by depositary banks, consistent with return timeframes and processes that apply to commercial depository institutions under Regulation CC[17] and the Uniform Commercial Code.[18] We further recommend that Treasury consider changing its practices so that canceled Treasury checks are returned directly to depositary banks rather than to presenting banks. This would mark a change from Treasury's current practice of advising the presenting bank that payment is being reclaimed through a Notice of Direct Debit. Rather than notifying, or returning the item to, source or "depositor" (i.e., the financial institution that presented the Treasury check for payment), we encourage Treasury to have the Federal Reserve Banks return such checks directly to the bank of first deposit.[19]

This would reduce the time required for a canceled check to be received by the depositary bank and for that depositary bank to debit the account of the customer that deposited the canceled check. If

[14] *Id.* at 6675.

[15] *See id.* at 6679 (to be codified at 31 C.F.R. § 240.12(a)(1)(iv)).

[16] It was unclear from the proposal whether Treasury intends to provide the Federal Reserve Banks with this information in a timely fashion similar to the manner in which it would be provided to TCVS. We expect this to be case, but if that is not the case, we strongly encourage Treasury to do so.

[17] *See* 12 C.F.R. § 229.31(b)(1).

[18] *See* U.C.C. § 4-302.

[19] We note that Treasury currently identifies the bank of first deposit on its Notices of Direct Debit, so that information is readily available (as it is provided in the image cash letters presented through the Federal Reserve Banks).

Treasury implemented such an approach, it would be able to achieve the same goal (namely, the reduction of POCs and related losses) in a significantly more efficient manner since all Treasury checks must be presented through a Federal Reserve Bank. We strongly recommend this approach rather than requiring all the thousands of financial institutions that accept Treasury checks to update their systems and processes to use TCVS to determine a Treasury check's validity before the check is accepted for deposit and processed for clearing.[20] For the reasons discussed below, we firmly believe that use of TCVS should remain optional.

We believe Treasury has significantly underestimated the burdens the proposal would place on financial institutions, which would have to modify systems and processes across numerous check acceptance channels (e.g., in person/branch, ATMs, remote deposit capture, lockbox, image cash letter services for commercial customers). We expect that required use of TCVS on all Treasury checks and the implementation of controls to prevent deposit and presentment of canceled Treasury checks might have negative impacts on customer experience, including by slowing down teller lines and preventing the deposit of Treasury checks through electronic deposit channels. We also expect that financial institutions would need to update their recordkeeping practices to maintain documentation of their use of TCVS to verify the validity of a Treasury check (to capture the date, time, and response provided by TCVS to the queries financial institutions make of that system). To the extent a financial institution is to be held liable under the proposed framework, TCVS should include as core functionality the ability to generate and retain records that show an institution used the system with respect to that check. This functionality should be available regardless of whether the institution uses TCVS through an application programming interface (API) or through Treasury's website, and it should permit the institution to retain or obtain a copy of such records. Furthermore, it is unclear from the proposal how Treasury expects a financial institution to handle a canceled Treasury check once it learns of the cancellation through TCVS.[21] For instance, would the financial institution be expected to void the check and hand it back to the customer? How would this work if the check was deposited through remote deposit capture or another deposit channel where the depositor is not depositing the physical check in person in front of a teller? We encourage Treasury to address this issue in its final rulemaking or in ancillary guidance.

As previously stated, we believe the preferable approach to achieve Treasury's aims is for Treasury to provide the Federal Reserve Banks with information about canceled Treasury checks and require the Reserve Banks to refuse to pay and expeditiously return the checks directly to the depositary bank (or bank of first deposit) rather than to the presenting bank. A major virtue of this approach would be that Treasury could immediately implement it since it would require no significant changes on the part of financial institutions. If, however, Treasury were to require financial institutions to use TCVS to confirm the validity of all Treasury checks and to prevent the presentment of any checks that have been canceled, the proposed 30-day implementation timeline Treasury has proposed is insufficient. Based on current deposit technology, practices, and procedures, many financial institutions would require at least 24 months' advance notice to implement the considerable changes that would be necessary.

[20] Institutions could still use TCVS if they chose to do so.

[21] We further note that the presentment guarantees under 31 C.F.R. § 240.4 are made by every "guarantor," which is defined to mean "a financial institution that presents a check for payment and any prior indorser(s) of a check." Thus, as written, Treasury's proposal would effectively require any indorser of a Treasury check (including the payee) to use TCVS to confirm a Treasury check's validity, which we do not believe is Treasury's intent.

These changes would include technology modifications, coordination with relevant vendors, updates to procedures, employee training, and other steps to introduce a mandatory TCVS validation control point on all Treasury checks, as well as the ability to interdict the forward-collection process, across all check deposit acceptance channels. We further note that the proposal would require financial institutions to revise their customer engagement practices for scenarios in which a Treasury check is canceled and to modify their document retention policies and practices so appropriate records are available if Treasury exercises its reclamation rights due to a canceled check. Thirty days is simply not an adequate period to implement these extensive changes. Furthermore, it is critical that the implementation timeline begin only after both (i) Treasury delivers a "final" TCVS solution to the industry and (ii) financial institutions have had a reasonable period to test the updated TCVS solution as they work to make the changes described earlier in this paragraph.

In addition, to the extent a new mandate to use TCVS is imposed, TCH and BPI encourage Treasury to clarify in the Treasury Check Regulation that Treasury may not use the reclamation process to recover the amount of a payment for a canceled Treasury check from a guarantor if the guarantor had confirmed the check's validity through TCVS or if TCVS was unavailable at the time the guarantor attempted to use it.[22] Conversely, the Treasury Check Regulation should be revised to make clear that a financial institution may protest a reclamation if (i) the financial institution used TCVS to confirm a check's validity or (ii) TCVS was unavailable when the financial institution sought to confirm a check's validity prior to presentment. Furthermore, to the extent the mandate is imposed, Treasury should ensure that prior indorsers of Treasury checks, such as nonbank check cashers, have access to TCVS.

Consistent with 31 U.S.C. § 3332(f), we also encourage the federal government to minimize the use of Treasury checks as a method of payment and to move such payments to ACH or other electronic methods to the extent possible.

III. Conclusion

TCH and BPI have proposed a solution that would reduce Treasury's POC losses and costs, without the need for financial institutions to implement systems and processes unique to the acceptance of Treasury checks from customers. Treasury would provide canceled check information to the Federal Reserve Banks, which would be required to timely return to depositary banks Treasury checks that had been canceled. TCH and BPI support the enhancements to TCVS that have been proposed, as well as additional improvements to help reduce fraud. However, use of TCVS should remain optional for financial institutions so they may use it at their discretion to reduce their risk of loss pending returns or reclamations after Treasury checks have been processed for deposit, not to prevent the deposit and collection of such checks in the first place.

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Thank you for your consideration and review of these comments. If you have any questions or wish to discuss this letter, please contact Stephen Krebs (stephen.krebs@theclearinghouse.org) or Greg Cavanagh (greg.cavanagh@theclearinghouse.org) for TCH or Christopher Feeney (chris.feeney@bpi.com)

[22] The former would be equivalent to 31 C.F.R. § 240.8(c), which prohibits Treasury from seeking reclamation on a counterfeit check "unless the reclamation debtor has failed to make all reasonable efforts to ensure that a check is an authentic check and not a counterfeit check."

for BPI. We note, too, that we would be pleased to meet jointly with staff from the Federal Reserve if that would be helpful.

Sincerely,

/s/ Robert C. Hunter

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