Thrift Bulletin

Handbook: Compliance Activities
Subject: Expedited Funds Availability Act

Section: 335
TB 9-1

October 4, 1989

Recent Changes to Federal Reserve Board Regulation CC and Official Staff Commentary

Summary: The Federal Reserve Board has recently adopted changes to its Regulation CC implementing the Expedited Funds Availability Act and its accompanying Official Staff Commentary.

For Further Information Contact:
The Office of Thrift Supervision for the District in which you are located or the Division of Compliance Programs, Office of Thrift Supervision, Washington, D.C.

Thrift Bulletin 9-1

The Federal Reserve has recently adopted a number of amendments to Regulation CC (12 CFR 229) and the Official Staff Commentary to that regulation. The regulation requires depository institutions to make funds available to their customers within specified times, to disclose their funds availability policies to their customers, and to handle checks expeditiously.

Attachment A contains the Federal Reserve Board's final rule setting forth changes to the regulation and commentary. The amendments are largely technical in nature, and are designed to resolve ambiguities and facilitate compliance with the regulation.

Attachment B contains the Federal Reserve Board's August 4, 1989 *Federal Register* notice which addresses regulatory changes to Regulation CC, 229.36 and 229.38 and the corresponding commentary sections. The amendments are designed to alleviate the operational difficulties and additional risks associated with the acceptance for deposit of bank payable through checks (see also TB 9, November 30, 1988). The amendments to section 229.36 are effective February 1, 1991; the amendments to section 229.38 are effective February 1, 1990.

Attachments

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Attachment A to TB 9-1

Federal Reserve System
(Docket No. R-0649)
Regulation CC
12 CFR Part 229

Availability of Funds and Collection of Checks

Final Rule

FEDERAL RESERVE SYSTEM

[Docket No. R-0649]

Regulation CC

12 CFR Part 229

Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting a number of amendments to Regulation CC and its Commentary (Appendix E to Regulation CC). The regulation requires banks to make funds available to their customers within specified times, to disclose their funds availability policies to their customers, and to handle returned checks expeditiously. Since the publication of Regulation CC, the Board has received numerous requests from banks and others for clarification of various provisions of the regulation. The Board believes that the changes to Regulation CC and its Official Commentary (Appendix E) respond to many of these questions and will aid banks in understanding and complying with the regulation.

EFFECTIVE DATE: The effective date for the amendment to § 229.2(e) regarding agencies of foreign banks and the amendment to Appendix A is August 10, 1989. All other amendments are effective April 10, 1989.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202/452-3874) or Gayle Thompson, Program Leader (202/452-2934), Division of Federal Reserve Bank Operations;

Oliver I. Ireland, Associate General Counsel (202/452-3625) or Stephanie Martin, Attorney (202/452-3198), Legal Division; or Thomas J. Noto, Attorney (202/452-3667), Division of Community and Consumer Affairs. For the hearing impaired only, Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: On May 13, 1988, the Board adopted Regulation CC (12 CFR Part 229) to carry out the provisions of the Expedited Funds Availability Act ("Act") (12 U.S.C. 4001-4010). See 53 FR 19372 (May 27, 1988). The regulation requires banks to make funds available to their customers within specified times, to disclose their funds availability policies to their customers, and to handle returned checks expeditiously. After the publication of Regulation CC, the Board received numerous requests from banks and others for clarification of various provisions of the regulation. In October 1988, the Board proposed changes to Regulation CC and its Official Commentary (Appendix E) to respond to many of these questions and to aid banks in understanding and complying with the regulation (53 FR 44343, November 2, 1988).

The Board received 63 comments on the proposed amendments. Commenters comprised:

Commercial banks	26
Bank holding companies	15
Trade associations	10
Savings and loan institutions	4
Clearinghouses	3
Banking service corporations	2

Credit unions	1
Federal Home Loan Banks	1
Law firms	1

The final amendments and substantive comments are summarized below.

Section 229.2 (Definitions)

(d) Available for withdrawal. The Commentary originally stated that funds are considered to be available for withdrawal even though they cannot be used because they are subject to garnishment, tax levy, or court order restricting disbursements from the account. The Board proposed to revise the Commentary to make it clear that when a bank places a hold on funds set aside as a result of the certification of a check, a check guaranty, purchase of a cashier's check, or similar transaction, the bank has not failed to make funds available for withdrawal.

Two commenters suggested that the Board clarify that funds should be considered available for withdrawal if used by a bank in accordance with its right of set-off or if a bank holds the funds "in an account prior to initiation of a wire transfer." The final revision expands on the proposed language to make it clear that the Commentary's list of reasons is not exhaustive and clarifies that banks are permitted under the regulation to place a hold on funds to cover a check that was certified or purchased and not debit the account until the check is presented for payment.

(e) Bank. The Expedited Funds Availability Act's

definition of "depository institution" includes "an office, branch, or agency of a foreign bank located in the United States" (12 U.S.C. 4001(12)). The definition of bank in Regulation CC, for purposes of subpart B, originally included only branches of foreign banks as defined in the International Banking Act (12 U.S.C. 3101). In some cases, however, agencies of foreign banks may hold accounts. Accordingly, the Board proposed an amendment to the definition of "bank," for purposes of subpart B, to cover agencies of foreign banks that are located in the United States. (Agencies of foreign banks are already included in the definition of "bank" for purposes of subpart C.) Offices of foreign banks in the United States that are not branches or agencies are not permitted to hold accounts. No substantive comments were received on this change, and the Board has adopted the amendment as proposed. This amendment will become effective 120 days following its final adoption to provide agencies of foreign banks sufficient time to implement the requirements of subpart B.

In addition, the Act did not include Edge Act corporations, agreement corporations, and commercial lending companies (such as banking companies incorporated under Article XII of the New York Banking Law) under the definition of "depository institution"; consequently, the Board did not subject them to the availability and disclosure requirements of subpart B of Regulation CC. For purposes of subpart C, however, the term "bank" also includes any person engaged in the business of

banking, so that the same rules apply to the return of checks by institutions that do not hold "accounts" as apply to institutions that do hold "accounts." Edge Act corporations, agreement corporations, and commercial lending companies pay and return checks and drafts and would generally be considered to be engaged in the business of banking. The Board proposed to revise the Commentary to the definition of "bank" to clarify the status of Edge Act and similar corporations under the regulation. No substantive comments were received on this change, and the Board has adopted the revision as proposed.

(f) Banking day and (g) Business day. The Commentary to these definitions originally stated that deposits made to an ATM are considered made at the branch holding the account into which the deposit is made for the purpose of determining the day of deposit. The Board believes that it is appropriate to apply this rule to deposits made at off-premise facilities, such as remote depositories and lock boxes, as well as at ATMs. All other deposits should be considered made at the branch at which the deposit is received for purposes of determining the day of deposit. The Board proposed to revise the Commentary accordingly.

Many commenters requested that the Board clarify the interaction of the proposed Commentary to the definitions of "banking day" and "business day" and § 229.19(a). The commenters stated that it was unclear under the proposed language whether

deposits to off-premise facilities would still be considered received in accordance with § 229.19(a). The Board has added language in the final revision to the Commentary to clarify the relationship between the two sections.

(i) Cashier's check and (gg) Teller's check. Sections 229.2(i) and (gg) of the regulation define "cashier's check" and "teller's check." The Board has received several inquiries as to the types of checks that are included within these definitions. One commenter requested that the Board revise the Commentary to the definition of "teller's check" to include checks drawn by a nonbank and payable through a bank. The Board has clarified that such checks are not considered teller's checks under the Act, and has expanded the Commentary to the definitions of "teller's check" and "cashier's check" to make further clarifications.

(k) Check. The Commentary to the definition of "check" originally stated that a credit card draft is not considered a check for purposes of the regulation. The Board proposed to clarify the term "credit card draft" by revising the Commentary to specify that the term includes sales drafts used by merchants or generated by banks but excludes checks that banks provide to their customers as a means of accessing credit lines without the use of credit cards. Two commenters expressed confusion regarding the proposed revision, in particular as to what checks would be excluded as "credit card drafts." The Board has revised the Commentary to eliminate confusion.

(u) Noncash item. The definition of noncash item includes an item that would otherwise be a check, except that it has not been preprinted or post-encoded in magnetic ink with the routing number of the paying bank. Under the definition of "paying bank," published by the Board as an interim rule on August 18, 1988 (53 FR 31290) and adopted as a final rule on November 2, 1988 (53 FR 44324), the routing number on certain payable through checks may no longer be that of the paying bank for purposes of subpart B of the regulation. The Board is revising the Commentary to clarify that, in the context of this definition, "paying bank" refers to the paying bank for purposes of subpart C. This amendment clarifies that checks payable through a bank are not noncash items.

(z) Paying bank. The definition of "paying bank" originally included the state or unit of general local government on which a check is drawn. Some states and local governments issue checks drawn on themselves, but designate the checks as payable through or at a bank. The Board proposed to amend the definition of paying bank to provide that a state or unit of general local government is a paying bank only if the check is actually sent to the state or unit of general local government for payment or collection. No substantive comments were received regarding this change, and the Board has adopted the amendment as proposed. The Board has also approved a related amendment, as proposed, to conform the warranty provisions in § 229.34(a) and

(b) to the definition of "paying bank."

(bb) Qualified Returned Check. The regulation defines a qualified returned check ("QRC") as one that has been prepared for automated return to the depositary bank by placing the check in a carrier envelope or placing a strip on the check and encoding the strip or envelope in magnetic ink. Under § 229.31(a), a returning bank's return deadline is extended by one business day if the returning bank converts a returned check to a QRC.

Under the current regulation, returning banks that might want to use another technology for automating returned check processing may not extend their return deadline when using a methodology other than that defined for a QRC. The Board requested comment on whether a broader definition of QRC is warranted to accommodate different technologies, whether banks would use an alternative method of qualifying returned checks if it were available, whether the number of alternative methodologies allowed should be limited, and whether a returning bank should be permitted to extend its return deadline by the additional day to prepare the returned check for processing using another technology if the returned check had originally been qualified by the paying bank.

Twenty-seven commenters opposed broadening the definition of QRC at this time. The reasons cited were a need for uniformity, a need to adapt to the new return system as it exists

before experimenting with new technologies, and the need for careful industry study before implementing alternative means of creating QRCs. Six commenters favored broadening the definition now, but three believed the Board should do so only in "a limited way."

Nineteen commenters opposed and two commenters favored allowing an extra day for a returning bank to qualify a returned check using an alternative technology. Some of those opposed said they would favor the extra day if an agreement was reached between the interested banks or if it would ultimately speed the return. Most commenters said that they would use a new technology in the future if it is sufficiently studied and tested, cost-efficient, and available to all banks. The final amendment does not expand the definition of QRC nor does it allow an extra day for qualifying a returned check using an alternative technology. The Board will, however, continue to study new technologies and options for speeding the return process and may make further proposals in the future.

In addition, the Board proposed to clarify the Commentary to indicate that QRCs prepared using envelopes preprinted with the return item identifier may conform to the guidelines established in Specification for the Placement and Location of MICR Printing, X9.13 by the American National Standards Committee on Financial Services (Sept. 8, 1983) ("ANSI guidelines") for the external processing code ("EPC") field for printing the

identifier. The ANSI guideline states that the EPC field is located within 1/4 inch to the left of the routing number, thus allowing the identifier to be in either position 44 or position 45 on preprinted envelopes.

The commenters generally approved of universal standards for carrier strips and envelopes. Several commenters opposed the proposal that the "2" identifier be allowed in either position 44 or 45 because their software is capable of reading position 44 only. Since the publication of the proposed amendment, the Board has learned that the ANSI guidelines regarding the EPC field are in the process of revision. The Board will delay action on this amendment until the new ANSI standards are finalized.

(cc) Returning bank. The definition of "returning bank" in Regulation CC originally stated that a returning bank is a collecting bank for purposes of U.C.C. § 4-202(1)(e), which specifies a collecting bank's duty to notify its transferor of delays in transit. On further consideration, the Board did not believe that it was necessary for Regulation CC to require that a returning bank notify its transferor of any loss or delay in transit, and therefore the Board proposed to delete this reference from the definition.

One commenter objected to the deletion, stating that the transferor needs the notice for chargeback and monitoring purposes. The Board believes, however, that while such a notice is necessary in the forward collection process, when collecting

banks may be in doubt as to whether the check will be paid, it is not as important in the return process, when payment is generally assured as long as the depositary bank is solvent. A returning bank will still be a collecting bank for purposes of U.C.C. § 4-202(2), which sets out when a collecting bank's action would be considered to be seasonable, and a returning bank is analogous to a collecting bank for purposes of final settlement. Therefore, the Board is adopting the amendment to the regulation as proposed and has added clarifications to the Commentary accordingly.

(kk) Unit of general local government. The Board has been asked whether Indian nations are considered to be units of general local government within the meaning of Regulation CC. The Act provides next-day availability for checks drawn by a unit of general local government. Under the Act, a unit of general local government is defined as any city, county, town, township, parish, village, or other general purpose political subdivision of a state. As Indian nations are not subdivisions of the states, Indian nations are not units of general local government within the meaning of the Act, and the Board consequently proposed a revision to the Commentary to make it clear that Indian nations are not included within the meaning of this term. No substantive comments were received on this revision, and the Board has adopted it as proposed.

Section 229.10 (Next-Day Availability)

Certain check deposits. The Commentary to § 229.10 originally stated that banks are required to provide next-day availability (or two-day availability under § 229.10(c)(2)) for Federal Reserve Bank and Federal Home Loan Bank checks. The Board proposed to revise the Commentary to provide that the next-day and second-day availability requirements apply only to checks that are encoded with a routing number listed in Appendix A to the regulation. Banks generally must rely on the routing number to determine whether these checks are subject to next-day availability because the banks cannot require the use of special deposit slips to identify them. The routing numbers assigned to the Federal Reserve Banks and Federal Home Loan Banks may change from time to time, and the Board does not believe that banks should be held liable for not providing next-day availability for a Federal Reserve Bank or Federal Home Loan Bank check that contains a newly issued routing number that has not yet been included in Appendix A.

One commenter favored the proposal that a bank should be able to rely on the routing numbers published in Appendix A for giving next-day availability to certain checks, but suggested that Appendix A updates have a delayed effective date to facilitate depositary bank programming changes. The Board will update Appendix A periodically to incorporate recently issued Federal Reserve Bank and Federal Home Loan Bank routing numbers and will allow a lead time for banks to update their computer

systems before imposing liability. The Board adopted the revision as proposed.

In addition, § 229.13(a) of the regulation requires that depositary banks give next-day availability to traveler's checks when they are deposited to new accounts. The Board proposed to add a sentence to the Commentary to § 229.10 that cites this requirement, cross-referencing the new account exception in § 229.13. Several commenters suggested that, to avoid confusion regarding the proposed language, the Commentary should clarify that traveler's checks are "included in the $5000 aggregation" for next-day availability for new accounts. The Board has redrafted the final revision to the Commentary to make this clarification.

Deposits made to an employee of the depositary bank. In most cases, § 229.10(c) conditions next-day availability on the check being deposited in person to an employee of the depositary bank. Deposits made through the mail or at an ATM or night depository must be made available not later than the second business day after the banking day of deposit. Some questions have been raised about the meaning of the term "in person to an employee of the depositary bank," e.g., whether it covers situations where a bank sends a courier to the customer to pick up checks for deposit. The language used by the Act is "deposited in a receiving depository institution which is staffed by individuals employed by such institution" (12 U.S.C.

4002(a)(2)), and the Act defines "receiving depository institution" to mean "the branch of a depository institution or the proprietary ATM in which a check is first deposited" (12 U.S.C. 4001(20)). The Board interprets these provisions as requiring next-day availability only for deposits made to staff of the depositary bank at a branch of the bank. Under § 229.10(c)(2), second-day availability would apply to deposits described in this section that are made at a teller station staffed by a person that is not an employee of the depositary bank (e.g. a shared staffed teller facility located in a retail store) and to deposits picked up at the customer's premises by an employee of the depositary bank. Accordingly, the Board proposed revisions to this section of the Commentary to make these clarifications. One commenter requested clarification in the Commentary as to the day of deposit for deposits picked up by an employee of the depositary bank at the customer's premises. The Board has made this clarification in the final revision and otherwise has adopted the revision as proposed.

Fees for withdrawals. The Commentary to § 229.10(c) originally prohibited a depositary bank from imposing a fee on a customer when the customer withdraws funds that must be made available under the regulation but for which the bank has not yet received credit. The Board intended this provision to prevent practices designed to discourage customers from exercising their right to withdraw these funds in accordance with the regulation.

Banks have expressed concern, however, that this provision could be interpreted to prohibit the application of account analysis programs commonly used by banks under which earnings credits are computed on the basis of collected balances. The Board believes that such programs are generally adopted for legitimate purposes and not for purposes of evading the requirements of the Act. Because of the difficulties in distinguishing these programs from devices to evade the requirements of the Act, the Board proposed to delete this provision of the Commentary.

Thirteen commenters supported the Board's deletion of this provision, stating that the change will prevent widespread confusion and operating problems throughout the industry. Five commenters opposed the proposal, stating that the deletion would invite abuses of the regulation by depositary banks. The Board believes that the difficulties caused by the fee for withdrawal language to legitimate account analysis programs outweighs the danger of abuse of the regulation by depositary banks. The final amendment deletes the fee for withdrawal language, but the Board plans to monitor the practices of banks in this area and may consider specific restrictions if it determines that abuses are occurring.

Special deposit slips. The Commentary originally stated that if a bank only provides special deposit slips upon the customer's request, the bank's tellers must advise customers of the special deposit slips' availability. Because banks indicated

that this requirement places a difficult burden on tellers, the Board proposed to delete the reference to the tellers' duties. Some commenters expressed concern that if the Board deleted this reference, customers would be told of the availability of such slips only at the time they receive their initial disclosures. The Board is revising the Commentary to indicate that either tellers can advise customers of the availability of special deposit slips, or the bank may post a notice indicating that special deposit slips are available upon request. The notice may be placed, for example, at teller windows or near or with the lobby notice required under § 229.18(b).

Section 229.11 (Temporary Availability Schedule)

(c) Nonlocal checks. Under the temporary schedule, funds deposited by nonlocal check must be made available for withdrawal no later than the seventh business day following the banking day of deposit. The Commentary originally stated that exceptions to this rule include deposits in accounts of banks located outside the 48 contiguous states and deposits made to nonproprietary ATMs. The Board proposed to delete the reference to nonproprietary ATM deposits because § 229.11(d) already requires that all checks deposited at nonproprietary ATMs be made available no later than the seventh business day following the banking day of deposit. No substantive comments were received on this change, and the Board adopted the revision as proposed.

Section 229.13 (Exceptions)

(b) Large deposits. Section 229.13(b) permits a depositary bank to extend the hold placed on local and nonlocal check deposits to the extent that the aggregate amount of the deposit on any banking day exceeds $5,000. After the final rule was adopted, several banks asked if there is a rule to determine what portion of a large-dollar deposit that is composed of both local and nonlocal checks should be made available in accordance with the schedule and which checks may be held for a longer period of time under this exception. The Board intended to leave this determination to the discretion of the depositary bank, and proposed a revision to the Commentary to clarify this point. No substantive comments were received on this change, and the Board has adopted the revision as proposed.

(e)(2) Overdraft and returned check fees. Originally, the last sentence of this paragraph of the regulation stated that "[t]he overdraft and returned check notice must state that the customer may be entitled to a refund of overdraft or returned check fees . . . ." This sentence, when read with the notice requirement of § 229.13(g), could have been interpreted to require banks to provide duplicate notices to their customers in certain cases. The Board proposed to amend the last sentence of this paragraph to clarify that only one notice is required. No substantive comments were received on this change, and the Board has adopted the amendment as proposed.

Section 229.16 (Specific Availability Policy Disclosure)

The Board is clarifying two disclosure issues that have been raised since Regulation CC took effect. These clarifications would not require banks to change disclosures that have already been printed or mailed.

(a) General. Section 229.16(a) of the regulation requires banks to provide their customers with a specific policy disclosure that reflects the bank's availability policy followed in most cases. The Board proposed two revisions to the Commentary to clarify this provision. First, the Board proposed to clarify that if a bank discloses the policy it follows in most cases, it need not disclose to some customers that they may get faster availability. In addition, the Board proposed to clarify that a bank does not violate the disclosure requirements of the regulation if it pays checks written on an account prior to the day funds in the account become available for withdrawal according to its disclosure. Generally, as long as funds are not available for withdrawal for all uses permitted to the customer, they are not "available for withdrawal" as that term is defined in the regulation and, generally, disclosures based on the time that funds are available for all uses are proper. No substantive comments were received on these changes, and the Board has adopted the revisions as proposed.

(b) Content of specific availability policy disclosure. Section 229.16(b) of the regulation describes the required contents of the specific availability policy disclosure. The

Board proposed to revise the Commentary to § 229.16(b) to clarify that a bank that provides availability based on when the bank generally receives credit for deposited checks need not disclose the time when a check drawn on each bank will be available for withdrawal. Instead, the Board proposed that the bank may disclose the categories of deposits that must be available on the first business day after the day of deposit, state the other categories of deposits and the time periods that will be applicable to those deposits, and state that the customer may request a copy of the bank's schedule for when deposits of those checks will be available for withdrawal. No substantive comments were received on this change, and the Board has adopted the revision as proposed.

(c)(3) Overdraft and returned check fees. The last sentence of this paragraph of the regulation originally stated that "[t]he overdraft and returned check notice must state that the customer may be entitled to a refund of overdraft or returned check fees. . . ." This sentence, when read with the notice requirement in § 229.16(c)(2), could have been interpreted to require banks to provide duplicate notices to their customers in certain cases. The Board proposed to amend the last sentence of this paragraph to read "the notice must state that the customer may be entitled to a refund of overdraft or returned check fees. . . ." No substantive comments were received on this change, and the Board has adopted the revision as proposed.

Section 229.19 (Miscellaneous)

(a) When funds are considered deposited. This paragraph establishes rules to determine when funds are considered received in various circumstances. Rules applicable to deposits made at staffed teller stations differ from those that apply to deposits made at off-premises facilities, such as lock boxes or night depositories. The Board proposed a revision to the Commentary to clarify that the rules applicable to funds deposited in a deposit box located in the lobby of the bank should be similar to the rules for funds received at a staffed teller station. Seven commenters favored the proposal, stating that the change is reasonable in light of customer expectations but that the Board should clearly distinguish between boxes inside the lobby and boxes attached to the lobby but accessed from outside. Six commenters were opposed, explaining that for security reasons, lobby boxes are not emptied while the lobby is open to the public, and consequently it is impractical to treat those deposits the same as deposits to a teller. One commenter suggested that a notice on the lobby box as to when funds will be considered received would be sufficient. The final revision provides that a lobby box deposit is treated the same as a deposit to a staffed teller station, unless the bank treats lobby box deposits the same as deposits to night depositories and provides a notice on the lobby box informing customers when deposits at the lobby box will be considered received.

Section 229.19(a)(5)(ii) permits a bank to establish a cut-off hour of 2:00 p.m. or later, after which deposits may be considered made on the following banking day. This provision is similar to U.C.C. § 4-107. Recognizing that many banks close before 2:00 p.m., the Commentary notes that this provision does not require banks to stay open until 2:00 p.m. The language in the Commentary raised a number of issues, such as the effect of closing most of the bank but leaving drive-up teller windows open. The Board proposed a revision to the Commentary to clarify the effect of closing practices on cut-off hours. The Board received one comment regarding the provision prohibiting a bank from considering checks accepted at certain teller stations before 2:00 p.m. as the next day's deposits. The commenter stated that prohibiting this practice would hurt many small rural banks that must close their teller windows before 2:00 p.m. to meet courier schedules. The commenter stated that these banks would incur greater risk by losing a day of collection time for those deposits accepted before 2:00 p.m. but after the courier deadline. Regulation CC, however, incorporates the U.C.C.'s existing 2:00 p.m. cut-off hour for over-the-counter deposits, thus these delays already occur. The Board has adopted the final revision as proposed, which reflects current law under the U.C.C.

(e) Holds on other funds. Section 229.19(e) of the regulation limits the hold a depositary bank may place on any funds of the customer due to a deposit to an account covered by

the regulation. For example, for deposits made to a customer's checking account, if a bank places a hold on funds in a nontransaction account, such as certain savings accounts, rather than the customer's checking account, the bank may place such a hold only to the extent that the funds held do not exceed the amount of the deposit and the length of the hold does not exceed the time periods permitted by the regulation. This restriction is intended to prevent evasion of a principal purpose of the Act, i.e., to limit holds on deposits to transaction accounts.

The regulation originally limited holds that a bank can place on funds of the customer if the customer cashes a check over the counter to holds that do not exceed the time periods prescribed in the regulation and do not exceed the amount of the check cashed. A number of banks argued that, as to checks cashed over the counter, the restriction was overly broad because cashing a check over the counter and placing a hold on a nontransaction account does not involve an "account" covered by the Act.

The Board proposed to amend § 229.19(e) so that, in the case of checks cashed over the counter, the regulation would not limit holds placed on funds that are not held in accounts as defined by the regulation. The comments on the proposal were split, four opposed and three in favor. Those opposed stated that the change was contrary to the spirit of the Act and invites abuses of hold periods. The Board believes, however, that it is

inappropriate to regulate holds when there has not been a deposit to or hold on an account covered by Regulation CC. The amendment to § 229.19(e) has been adopted as proposed. The Board has also clarified in the Commentary to § 229.19(e) that a depositary bank may not place a hold on any account when an on us check is cashed over the counter, because on us checks are considered finally paid when cashed.

Section 229.20 (Relation to State Law)

The Act (section 608, 12 U.S.C. 4007) provides that any state law in effect on or before September 1, 1989, that provides for a shorter hold for a category of checks than is provided under federal law will supersede the federal provision. Section 229.20 of the regulation provides for Board determinations, upon request, of whether state law relating to the availability of funds is preempted by federal law and also provides certain preemption standards.

In August 1988 and October 1988, the Board adopted preemption determinations with respect to the laws of several states. See, for example, 53 FR 32359 (Aug. 24, 1988). In formulating those preemption determinations, the Board adopted certain uniform principles that will apply in all Board preemption determinations. The Board proposed to revise the Commentary to § 229.20 to incorporate these principles for preemption determinations.

One commenter suggested that if a state law provides for

the same availability schedules as the federal law but does not provide for exceptions to the schedules, then the federal exceptions should apply. The Board believes that, under the Act, such a state law would, in effect, provide for a shorter hold period than federal law and would therefore supersede federal law to the extent that the federal exceptions provided a longer hold period.

One commenter argued that federal law should preempt state law when state availability schedules are the same as the federal schedules, as well as when state schedules are shorter. The Act, however, states that the federal law shall supersede inconsistent state laws, and the Board believes that state laws that are the same as the federal law are not inconsistent with the federal law. The commenter was also of the opinion that under the Act, state law may preempt federal law only if the state law applies to all federally insured depository institutions within a state; however, the Act provides that if state availability schedules are shorter than the federal schedules, then the state schedules shall supersede the federal schedules and shall apply to all federally insured depository institutions located within the state.

Another commenter suggested that because the relationship between state and federal law is often complicated, the Board should relieve banks from liability due to unintentional noncompliance due to that complex relationship; however, such a

revision would be contrary to the Act. The Board has adopted the revisions to this section of the Commentary as proposed.

Section 229.30 (Paying Bank's Responsibility for Return of Checks)

(a) Return of checks. Prior to the effective date of Regulation CC, a paying bank usually returned a check to the presenting bank and automatically received a refund of any provisional settlement it may have made. Under Regulation CC, the paying bank must make an expeditious return, which may or may not involve returning the check through the presenting bank. If the paying bank does not return through the presenting bank, it will receive payment for the check from the bank to which the check is returned (a returning bank or the depositary bank). In these cases, any credit given to the presenting bank is not charged back.

In rare cases, a paying bank that returns a check may not have settled for the check with the presenting bank. In such cases, if the paying bank returns the check other than through the presenting bank, it should be required to make prompt payment for the amount of the check to the presenting bank. The Board proposed to revise the Commentary to § 229.30(a) to clarify this point. No substantive comments were received on this change, and the Board has adopted the revision as proposed. In addition, the Board has added a cross-reference to the Commentary to § 229.33(a) regarding a paying bank's duty toward a party that

has breached a presentment warranty.

(b) Unidentifiable depositary bank. If a paying bank is unable to identify the depositary bank, it may return the check to any bank that handled the check for forward collection, even if that bank has not agreed to act as a returning bank. If a paying bank chooses this option, it must advise the collecting bank that it is unable to identify the depositary bank. The Board proposed to revise the Commentary to provide that this notice must be conspicuous, and that the paying bank may not prepare the check for automated processing.

Nine commenters opposed this proposal, and three specifically supported it. Those opposed stated that if the depositary bank is unidentifiable, the check would be returned faster if the paying or subsequent returning bank were allowed to qualify the returned check with the routing number of the prior collecting bank to which it is being sent (and also signify on the check that the depositary bank is unidentifiable). The commenters stated that, under their approach, the check would not have to be handled manually until it rejected at the prior collecting bank. The Board does not believe that return times would be shorter if the returned checks are qualified to the prior indorser. Further, the Board believes that in some cases such a check would be returned to the depositary bank later than would be the case had the check been handled as a raw return.

Commenters also stated that under the proposal, the paying

or returning bank would be charged a higher raw return fee because of another bank's error. Five commenters claimed that Federal Reserve Banks have been "dumping" returned checks on the prior collecting bank with the clearest indorsement without making a serious effort to identify the depositary bank. The commenters objected to this practice and were concerned that the liabilities were being shifted from the Reserve Bank to the prior collecting bank. One commenter suggested that the Board establish a procedure by which the cost of handling a returned check for which the depositary bank is unidentifiable is passed along to the bank at fault.

The Board believes that these problems are directly related to the ease of identifying depositary banks and that the number of returned checks for which the depositary bank is unidentifiable can best be reduced by improving the quality of depositary bank indorsements. The Federal Reserve Banks are currently working with depositary banks with poor-quality indorsements to improve indorsement legibility. The higher costs being imposed on paying banks due to poor depositary bank indorsements should be minimized as indorsement quality improves.

The Board further believes that by keeping unidentifiable depositary bank checks in the raw processing stream, paying and returning banks will have incentives to make additional efforts to identify the depositary bank. Allowing paying or returning banks to qualify returned checks sent to a prior indorser would

provide an incentive for the bank to qualify returned checks to the prior indorser to obtain the lowest per item fee rather than to make every effort to identify the depositary bank. In addition, a returning bank may have more familiarity with various depositary bank indorsements and may be able to determine the depositary bank, even when the paying bank is unable to do so. Accordingly, the Board has decided to adopt the proposed revision prohibiting the preparation of returned checks for which the depositary bank is unidentifiable for automated return.

In addition, several commenters asked the Board to define "conspicuous notice." The Board proposed a conspicuous notice requirement so that a bank that receives a returned check will be readily able to distinguish a check for which the depositary bank is unidentifiable from other returned checks. If returned checks for which the depositary bank is unidentifiable are received in a cash letter commingled with other returned checks, conspicuous notice would have to be given on each individual check for which the depositary bank is unidentifiable, for example in the form of a stamp on the check. If returned checks for which the depositary bank is unidentifiable are received in a separate cash letter, only one notice would need to be given for the entire cash letter. The final revisions to the Commentary have been revised accordingly.

Furthermore, the Commentary originally stated that the sending of a check to a bank that handles the check for forward

collection under this paragraph, but that has not agreed to handle returned checks expeditiously, is not subject to the requirements for expeditious return by the paying bank. The Board proposed to delete the phrase "but that has not agreed to handle returned checks expeditiously." The duty of expeditious return would not apply when a check for which the depositary bank is unidentifiable is sent to a prior indorser, regardless of whether the prior indorser agrees to handle expeditiously returned checks in general. No substantive comments were received on this change, and the Board has adopted the revision as proposed.

(f) Notice in lieu of return. This paragraph originally provided that a paying bank may send a notice of nonpayment in lieu of the physical check if the check is lost or otherwise unavailable. The Board does not believe that a check is unavailable merely because a bank has filed it in a way that makes its retrieval inconvenient or difficult. The Board proposed to clarify that notice in lieu of the return of the actual check should be permitted only when a bank does not have and cannot obtain possession of the check or must retain possession of the check for protest. Several commenters requested that a legible photocopy should be the only allowable form of notice in lieu. Others suggested that notices in lieu could be discouraged by providing that the paying bank send a fee to the depositary bank when it sends a notice in lieu. The Board

believes that the current requirements for the content of a notice in lieu provide the depositary bank with sufficient information. The Board recognizes that the cost of processing a notice in lieu can be higher than the cost of processing a returned check and has clarified the limited situations in which a notice in lieu may be sent. The final amendment includes the proposed language and also clarifies that the notice in lieu must be sent in the same manner as other returned checks. The final amendment makes these changes in both § 229.30(f) and § 229.31(f).

Section 229.31 (Returning Bank's Responsibility for Return of Checks)

(b) Unidentifiable depositary bank. This paragraph provides, among other things, that a returning bank that receives a check from a paying bank that could not identify the depositary bank must return the check expeditiously to the depositary bank if it is able to identify the depositary bank. The Board proposed to amend the regulation to clarify that this requirement also applies to checks that a returning bank receives from another returning bank where the prior returning bank is not able to identify the depositary bank.

Comments on this section were similar to those on § 229.30(b). One commenter suggested that the Board clarify that a bank must accept returns only if it agrees to handle returns or is the depositary bank or a prior collecting bank. Another

commenter suggested that if a prior collecting bank is able to identify the depositary bank by looking at the indorsement (which would indicate that the sender of the check had not made a good faith effort to make the identification), the prior collecting bank should be able to charge the sender a fee. One commenter asked the Board to establish a preferred sequence for where to send a check when the depositary bank is unidentifiable.

Because the comments on the proposed revisions to § 229.31(b) of the regulation generally referenced back to the Board's proposal regarding the Commentary to § 229.30(b), they are discussed above in that section. The proposed changes to § 229.31(b) of the regulation were intended to clarify that the same rules applied to returned checks received from a paying bank and those received from another returning bank. None of the comments directly addressed this issue, and the Board has adopted the amendment as proposed.

In addition, the Board proposed a revision to the Commentary to § 229.31(b). Originally, the Commentary stated that a returning bank may send a check for which the depositary bank is unknown to a returning bank that agrees to handle "the returned check" for expeditious return or to a prior collecting bank, even though the prior collecting bank does not agree to handle "returned checks" expeditiously. The Board proposed to change the phrase "returned checks" to "the returned check" to clarify that a returned check may be sent to a prior collecting

bank even though the prior collecting bank does not agree to handle the returned check expeditiously. No substantive comments were received on this change, and the Board has adopted the revision as proposed. In addition, the Board has added clarifying language similar to the language adopted in the Commentary to § 229.30(b) regarding conspicuous notice and the prohibition on qualifying a check for return if the depositary bank is unidentifiable. The Board has also added a cross-reference in the Commentary to § 229.31(c).

Section 229.32 (Depositary Bank's Responsibility for Returned Checks)

Under § 229.32(a)(2), a depositary bank must accept returned checks at a location consistent with the name and address of the depositary bank in its indorsement on the check, or, if no address appears in the indorsement, at a branch or head office associated with the routing number of the depositary bank in its indorsement. A depositary bank's indorsement could contain an address that is in a different check processing region from an address associated with the routing number in the indorsement. As returned checks will be routed on the basis of the routing number in the depositary bank's indorsement, the return of checks will be facilitated if returns can be made to an address in the same check processing region as the location associated with the routing number. Therefore, the Board proposed to amend § 229.32(a)(2) to provide that if the address

in the depositary bank's indorsement is not in the same check processing region as the address associated with the routing number in its indorsement, the depositary bank must accept returned checks at a branch or head office associated with the routing number in the indorsement.

Three commenters opposed the amendment, stating that it would force changes in operating procedures, cause a loss of efficiency, specialization, and economy of scale, and increase confusion and delay. Others suggested that as long as one address is known, it should be sufficient. One commenter supported the amendment only if the address associated with the routing number is a forward presentment receipt site.

The Board has adopted the amendment with slight modification. This amendment would not prevent a bank from centralizing its check processing operations to gain efficiencies and economies of scale. The Board believes that if a bank operating in multiple check processing regions chooses to centralize check processing at one site, then that bank should bear the extra cost of transporting checks to that site. Furthermore, paying banks generally return checks based on the depositary bank's routing number. A paying bank located in the same check processing region as the depositary bank should have the option of sending returned checks to the depositary bank's address that is associated with its routing number in its indorsement, rather than bearing the possibly higher cost of

delivery to a nonlocal processing center.

Section 229.32(a) also permits depositary banks to require that returned checks be sorted separately from forward collection checks. The intent of this provision is to require paying or returning banks to present returned checks to the depositary bank separately sorted from forward collection checks, unless the depositary bank agrees to take returned checks commingled with forward collection checks.

The Board proposed to add similar language to the regulation and Commentary to state that a depositary bank may require returned checks for which it is the depositary bank to be separately sorted from checks for which it is a returning bank, including those for which it is a prior indorser. This amendment was intended to facilitate the handling of checks that are returned to prior indorsers because of difficulty in identifying the depositary bank.

Five commenters opposed requiring separate cash letters for different types of returns. Those who opposed the proposal said that the benefits to the receiving bank were outweighed by the burden on the sending bank and that more errors and longer delays would result. Four commenters explicitly supported the proposal. The Board has found that most banks that receive returned checks both as prior indorser and depositary bank currently receive these checks commingled. The Federal Reserve Banks have received few complaints about the commingled cash

letters. Thus, the Board has determined that commingled return cash letters are not causing a problem and that current practices should be allowed to continue. The Board has not adopted the proposed amendment.

The Board also proposed to add a sentence to the Commentary to § 229.32(a) to clarify that, under § 229.33(d), a depositary bank receiving a returned check or notice of nonpayment must notify its customer by its midnight deadline or within a reasonable time. One commenter suggested that the amendment should read "must send notice to its customer" rather than "must notify its customer." The Board has incorporated this suggestion in the final revision.

Section 229.33 (Notice of Nonpayment)

(a) Requirement. This section requires a paying bank to give notice of nonpayment to the depositary bank if it determines not to pay a check of $2,500 or more. The Board proposed a revision to the Commentary to clarify that a paying bank's failure to give notice of nonpayment may be offset by a depositary bank's breach of warranty of title or other warranty regarding a check. One commenter disagreed with the proposal, stating that the paying bank should be responsible for failure to give notice of nonpayment in all instances. One rationale for the commenter's position is that, in some cases, the loss to the depositary bank would not occur but for the failure of the paying bank to give timely notice of nonpayment. At least one court has

agreed with the commenter's position, interpreting the warranty provisions of U.C.C. § 4-207(a)(1) and Regulation J to apply only when a paying bank pays the check and holding that a depositary bank's breach of presentment warranty did not absolve the paying bank from liability for failing to give timely notice of nonpayment. (See First American Savings v. M & I Bank, 57 U.S.L.W. 2406 (3rd Cir. 1989).)

The Board, however, believes that a paying bank should not be responsible to a depositary bank for failure to give notice in a case where the depositary bank has breached its warranty, such as where the check has been stolen or an indorsement forged. This position places the loss on the bank closest in the collection chain to party who is responsible for the check (e.g., the person who stole the check or forged the indorsement). Accordingly, the Board has adopted the amendment as proposed and has also added similar wording to the Commentary to § 229.30(a).

(d) Notification to Customer. This section requires a depositary bank to notify its customer upon receipt of a returned check or notice of nonpayment. The Board has received several requests from banks to clarify whether this duty applies to all returned checks or only to returned checks of $2,500 or more. The Board is revising the Commentary to clarify that this provision applies in the case of any returned check or notice of nonpayment, regardless of amount.

Section 229.34 (Warranties by Paying Bank and Returning Bank) and

Section 229.38 (Liability)

The Board proposed several technical amendments that are necessary to accommodate cases where a check is payable by one bank but payable through another. These amendments to § 229.34 and § 229.38 clarify that in cases of payable through checks payable by a bank, the bank by which the check is payable, not the payable through bank, makes the paying bank's warranties and is liable for the condition of the back of a check. No substantive comments were received regarding these changes, and the Board is adopting the amendments with slight technical modification.

Section 229.35 (Indorsements)

(a) Indorsement standards. The indorsement standard in § 229.35 and Appendix D specifies the information that must be included in a depositary bank's indorsement. The standard also permits depositary banks to include other identifying information in their indorsements. Some banks have included nine-digit zip codes in their indorsements. The Board believes that the inclusion of the nine-digit zip code could lead paying and returning banks to confuse the zip code with the routing number, which also contains nine digits. In order to prevent this confusion, the Board proposed to amend the Commentary to § 229.35(a) to advise depositary banks not to include in their indorsements information, such as a nine-digit zip code, that could be confused with required information, such as the

depositary bank's routing number. Eight commenters specifically favored the Board's proposal to discourage the use of numbers in depositary bank indorsements that could be confused with routing numbers, such as nine-digit zip codes. One commenter opposed the proposal on the grounds that use of the nine-digit zip code will grow over time. Another commenter suggested that any ban on use of nine-digit zip codes should allow a sufficient lead time for implementation. The Board has adopted the amendment as proposed. The Board is not banning the use of nine-digit zip codes in indorsements but is merely discouraging them.

The Board also proposed revisions to the Commentary to § 229.35(a) to reference the amendments to § 229.32(a) and to clarify that the collecting and returning banks must indorse checks for tracing purposes. No substantive comments were received on these changes, and the Board has adopted the revisions as proposed.

(b) Liability of bank handling check. This paragraph originally provided that a bank handling a check for forward collection or return may have the rights of a holder. The Board proposed to revise the Commentary to clarify that a bank may become a holder or a holder in due course regardless of whether prior banks have complied with the regulation's indorsement standards. No substantive comments were received regarding this change, and the Board has adopted the revision as proposed and has also added language to this section clarifying the use of the

term "final settlement."

Section 229.37 (Variation by Agreement)

The Commentary to this section notes that the Board did not adopt the rule stated in U.C.C. § 4-103(2), which provides that Federal Reserve regulations and operating letters, clearinghouse rules, and the like have the effect of agreements under the U.C.C. that apply to parties that have not specifically assented to them. The Board did not, however, intend to affect the status of such agreements under the U.C.C., and the Board proposed to clarify this point in the Commentary. No substantive comments were received regarding this change, and the Board has adopted the revision as proposed.

Appendix A (Routing Number Guide to Next-Day Availability Checks and Local Checks)

The Board is updating the list of Federal Home Loan Bank routing numbers to include a newly-issued routing number of the Houston Branch of the Federal Home Loan Bank of Dallas.

Appendix C (Model Forms, Clauses and Notices)

Forms C-1 through C-3 disclose that a bank generally provides next-day availability for all funds deposited to an account. Forms C-4 through C-7 list social security benefits and payroll payments as examples of preauthorized credits that are given next-day availability. Under U.S. Treasury regulations, government payroll and benefit preauthorized transfers must be made available on the payment date. ACH association rules

encourage banks to make direct deposit of payroll payments available to the customer on the payment date. The Board is adding language in the Appendix C Commentary to the model forms to clarify that banks that have relied on the model forms are protected from civil liability under § 229.21(e) as to disclosure of electronic payments, even though social security benefits and payroll payments are being made available on the same, not the next, business day. Banks are encouraged to revise their forms to reflect same-day availability for these electronic payments credits when reordering new stocks of forms.

Final Regulatory Flexibility Act Analysis

Two of the three requirements of a final regulatory flexibility analysis (5 U.S.C. 604), (1) a succinct statement of the need for and the objectives of the rule and (2) a summary of the issues raised by the public comments, the agency's assessment of the issues, and a statement of the changes made in the final rule in response to the comments, are discussed in the preamble above. The third requirement of a final regulatory flexibility analysis is a description of significant alternatives to the rule that would minimize the rule's economic impact on small entities and reasons why the alternatives were rejected. These changes are primarily clarifications to Regulation CC in response to questions and requests for clarification that the Board has received since Regulation CC was adopted. The Board considered the effect of these revisions when developing them and does not

believe the changes will result in any significant adverse economic impact on a substantial number of small entities.

One commenter stated that one of the revisions to the Commentary to § 229.19(a), which prohibits banks from considering checks received before 2:00 p.m. as the next day's deposits, would hurt small rural banks that close their teller windows before 2:00 p.m. to meet courier schedules. (See discussion in above preamble.) Under the Board's Commentary revision, certain remote banks may be unable to collect checks received for deposit close to the cut-off hour of 2:00 p.m., and consequently such checks may be returned later than checks deposited in time to meet the day's courier schedule. It is possible that the late return could increase the risk that the bank will have to make funds available before the check is returned. The Board believes that the risk associated with possible late returns applies only to a small number of remote banks and is dependent on the banks' location, courier schedule, and availability policy. The Board believes that the effect of the revision on small rural banks is minimal and that it would not be practical to attempt to define an exception to the cut-off hour provisions to address these situations.

List of Subjects in 12 CFR Part 229

Banks, banking; Federal Reserve System.

For the reasons set out in the preamble, Title 12, Chapter II, Part 229 of the Code of Federal Regulations is

amended as follows:

PART 229 -- AVAILABILITY OF FUNDS AND COLLECTION OF CHECKS

1. The authority of Part 229 continues to read as follows:

Authority: Title VI of Pub. L. 100-86, 101 Stat. 552, 635, 12 U.S.C. 4001 et seq.

2. In § 229.2, paragraphs (e)(7), (z)(5), and (cc) are revised to read as follows:

§ 229.2 Definitions.

* * * * *

(e) "Bank" means --

* * * * *

(7) An "agency" or a "branch" of a "foreign bank" as defined in section 1(b) of the International Banking Act (12 U.S.C. 3101).

* * * * *

(z) "Paying bank" means --

* * * * *

(5) The state or unit of general local government on which a check is drawn and to which it is sent for payment or collection.

* * * * *

(cc) "Returning bank" means a bank (other than the paying or depositary bank) handling a returned check or notice in lieu of return. A returning bank is also a collecting bank for purposes of U.C.C. § 4-202(2).

* * * * *

3. In § 229.13, the last sentence of paragraph (e)(2) concluding text is revised to read as follows:

§ 229.13 Exceptions.

* * * * *

(e) * * *

(2) Overdraft and returned check fees. * * * The notice must state that the customer may be entitled to a refund of overdraft or returned check fees that are assessed if the check subject to the exception is paid and how to obtain a refund.

* * * * *

4. In § 229.16, the last sentence of paragraph (c)(3) concluding text is revised to read as follows:

§ 229.16 Specific availability policy disclosure.

* * * * *

(c) * * *

(3) Overdraft and returned check fees. * * * The notice must state that the customer may be entitled to a refund of overdraft or returned check fees that are assessed if the check subject to the delay is paid and how to obtain a refund.

* * * * *

5. In § 229.19, paragraph (e) is revised to read as follows:

§ 229.19 Miscellaneous.

* * * * *

(e) Holds on other funds.

(1) A depositary bank that receives a check for deposit in an account may not place a hold on any funds of the customer at the bank, where --

(i) The amount of funds that are held exceeds the amount of the check; or

(ii) The funds are not made available for withdrawal within the times specified in 229.10, 229.11, 229.12, and 229.13.

(2) A depositary bank that cashes a check for a customer over the counter, other than a check drawn on the depositary bank, may not place a hold on funds in an account of the customer at the bank, if --

(i) The amount of funds that are held exceeds the amount of the check; or

(ii) The funds are not made available for withdrawal within the times specified in 229.10, 229.11, 229.12, and 229.13.

* * * * *

6. In § 229.31, the last sentence of paragraph (b) is revised to read as follows:

§ 229.31 Returning bank's responsibility for return of checks.

* * * * *

(b) Unidentifiable depositary bank. * * * A returning bank that receives a returned check from a paying bank

under § 229.30(b), or from a returning bank under this paragraph, but that is able to identify the depositary bank, must thereafter return the check expeditiously to the depositary bank.

* * * * *

7. In § 229.32, the word "or" is removed at the end of paragraph (a)(2)(ii), paragraph (a)(2)(iii) is redesignated as paragraph (a)(2)(iv), and a new paragraph (a)(2)(iii) is added to read as follows:

§ 229.32 Depositary bank's responsibility for returned checks.

(a) * * *

(2) * * *

(iii) If the address in the indorsement is not in the same check processing region as the address associated with the routing number of the bank in its indorsement on the check, at a location consistent with the address in the indorsement and at a branch or head office associated with the routing number in the bank's indorsement; or * * *

* * * * *

8. In § 229.34, paragraph (a)(1), the undesignated paragraph following paragraph (a)(4), paragraph (b), (b)(1), and the undesignated paragraph after paragraph (b)(3) are revised to read as follows:

§ 229.34 Warranties by paying and returning bank.

(a) <u>Warranties</u>. * * *

(1) The paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, returned the check within its deadline under the U.C.C., Regulation J (12 CFR Part 210), or § 229.30(c) of this part;

* * *

These warranties are not made with respect to checks drawn on the Treasury of the United States, U.S. Postal Service money orders, or checks drawn on a state or a unit of general local government that are not payable through or at a bank.

(b) Warranty of notice of nonpayment. Each paying bank that gives a notice of nonpayment warrants to the transferee bank, to any subsequent transferee bank, to the depositary bank, and to the owner of the check that --

(1) The paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, returned or will return the check within its deadline under the U.C.C., Regulation J (12 CFR Part 210), or § 229.30(c) of this part;

* * *

These warranties are not made with respect to checks drawn on a state or a unit of general local government that are not payable through or at a bank.

* * * * *

9. In § 229.38(d), the first sentence is revised to read as follows:

§ 229.38 Liability.

* * * * *

(d) Responsibility for back of check. A paying bank, or in the case of a check payable through the paying bank and payable by another bank, the bank by which the check is payable, is responsible for damages under paragraph (a) of this section to the extent that the condition of the check when issued by it or its customer adversely affects the ability of a bank to indorse the check legibly in accordance with § 229.35. * * *

* * * * *

Appendix A -- [Amended]

10. Appendix A is amended by adding a new routing number to the list, under the heading Federal Home Loan Banks, in numerical order, as follows:

* * * * *

1130 1750 8

* * * * *

Appendix E -- [Amended]

Section 229.2 -- [Amended]

11. The Commentary to § 229.2 is amended as follows:

a. In paragraph (d), removing the last sentence of the second paragraph and replacing it with two new sentences.

(d) Available for withdrawal. * * *

* * * For purposes of this regulation, funds are considered available for withdrawal even though they are being held by the bank to satisfy an obligation of the customer other than the customer's potential liability for the return of the check. For example, funds are available for withdrawal even though they are being held by a bank to satisfy a garnishment, tax levy, or court order restricting disbursements from the account, or to satisfy the customer's liability arising from the certification of a check, sale of a cashier's or teller's check, guaranty or acceptance of a check, or similar transaction.

b. In paragraph (e), revising the second paragraph.

(e) Bank. * * *

"Bank" is defined to include depository institutions, such as commercial banks, savings banks, savings and loan associations, and credit unions as defined in the Act, and U.S. branches and agencies of foreign banks. For purposes of subpart B, the term does not include corporations organized under section 25(a) of the Federal Reserve Act, 12 U.S.C. 611-631 (Edge corporations) or corporations having an agreement or undertaking with the Board under section 25 of the Federal Reserve Act, 12 U.S.C. 601-604a (agreement corporations). For purposes of subpart C, and in connection therewith, subpart A, any Federal Reserve Bank, Federal Home Loan Bank, or any other person engaged in the business of banking is regarded as a bank. The phrase "any other person engaged in the business of banking" is derived

from U.C.C. § 1-201(4), and is intended to cover entities that handle checks for collection and payment, such as Edge and agreement corporations, commercial lending companies under 12 U.S.C. 3101, certain industrial banks, and private bankers, so that virtually all checks will be covered by the same rules for forward collection and return, even though they may not be covered by the requirements of subpart B. For the purposes of subpart C, and in connection therewith, subpart A, the term may also include a state or a unit of general local government to the extent that it pays warrants or other drafts drawn directly on the state or local government itself, and the warrants or other drafts are sent to the state or local government for payment or collection.

* * * * *

c. In paragraphs (f) and (g), revising the last paragraph.

(f) Banking day and (g) Business day. * * *

The definition of "banking day" is phrased in terms of when "an office of a bank is open" to indicate that a bank may observe a banking day on a per-branch basis. A deposit made at an ATM or off-premise facility (such as a remote depository or a lock box) is considered made at the branch holding the account into which the deposit is made for the purpose of determining the day of deposit. All other deposits are considered made at the branch at which the deposit is received. For example, under

§ 229.19(a)(1), funds deposited at an ATM are considered deposited at the time they are received at the ATM. The day of deposit for such funds is determined by the banking day at the account-holding branch at the time the funds are received at the ATM. Similarly, under § 229.19(a)(3), funds deposited to a night depository, lock box, or similar facility are considered deposited when the funds are removed from the facility and are available for processing. If such a facility is not on the premises of a branch, the day of deposit is determined by the banking day at the account-holding branch. If such a facility is on branch premises, the day of deposit is determined by the banking day at the branch at which the deposit is received, whether or not it is the account-holding branch.

d. In paragraph (i), removing the second sentence and replacing it with two new sentences, and removing the last sentence and replacing it with four new sentences.

(i) Cashier's check. * * * The definition of cashier's check includes checks provided to a customer of the bank in connection with customer deposit account activity, such as account disbursements and interest payments. The definition also includes checks acquired from a bank by noncustomers for remittance purposes, including loan disbursement checks.

* * * The definition excludes checks that a bank draws on itself for other purposes, such as to pay employees and vendors, and checks issued by the bank in connection with a payment

service, such as a payroll or a bill-paying service. Cashier's checks are generally sold by banks to substitute the bank's credit for the customer's credit and thereby enhance the collectibility of the checks. A check issued in connection with a payment service is generally provided as a convenience to the customer rather than as a guarantee of the check's collectibility. In addition, such checks are often more difficult to distinguish from other types of checks than are cashier's checks as defined by this regulation.

e. In paragraph (k), revising the last paragraph.

(k) Check * * *

The definition of check does not include an instrument payable in a foreign currency (i.e., other than in United States money as defined in 31 U.S.C. 5101) or a credit card draft (i.e., a sales draft used by a merchant or a draft generated by a bank as a result of a cash advance). The definition of check includes a check that a bank may supply to a customer as a means of accessing a credit line without the use of a credit card.

f. In paragraph (u), adding a new sentence to the end of the second paragraph.

(u) Noncash item. * * *

* * * (In the context of this definition, "paying bank" refers to the paying bank as defined for purposes of subpart C.)

* * * * *

g. In paragraph (cc), revising the last sentence and adding a new sentence immediately following.

(cc) Returning bank * * * A returning bank is also a collecting bank for the purpose of a collecting bank's duty to act seasonably under U.C.C. § 4-202(2) and is analogous to a collecting bank for purposes of final settlement. (See Commentary to § 229.35(b).)

h. In paragraph (gg), removing the fourth sentence and replacing it with seven new sentences.

(gg) Teller's check * * * The definition does not include checks that are drawn by a nonbank on a nonbank even if payable through or at a bank. The definition includes checks provided to a customer of the bank in connection with customer deposit account activity, such as account disbursements and interest payments. The definition also includes checks acquired from a bank by a noncustomer for remittance purposes, including loan disbursement checks. The definition excludes checks used by the bank to pay employees or vendors and checks issued by the bank in connection with a payment service, such as a payroll or a bill-paying service. Teller's checks are generally sold by banks to substitute the bank's credit for the customer's credit and thereby enhance the collectibility of the checks. A check issued in connection with a payment service is generally provided as a convenience to the customer rather than as a guarantee of the check's collectibility. In addition, such checks are often more

difficult to distinguish from other types of checks than are teller's checks as defined by this regulation. * * *

i. Adding a new paragraph (kk) immediately following paragraph (ii).

(kk) Unit of general local government is defined to include a city, county, parish, town, township, village, or other general purpose political subdivision of a state. The term does not include special purpose units, such as school districts, water districts, or Indian nations.

Section 229.10 -- [Amended]

12. The Commentary to § 229.10(c) is amended as follows:

a. In paragraph (c) introductory text, revising the last sentence and adding two sentences to follow.

(c) . Certain check deposits. * * * For the purposes of this section, all checks drawn on a Federal Reserve Bank or a Federal Home Loan Bank that contain in the MICR line a routing number that is listed in Appendix A are subject to the next-day availability requirement if they are deposited in an account held by a payee of the check and in person to an employee of the depositary bank, regardless of the purposes for which the checks were issued. For all new accounts, even if the new account exception is not invoked, traveler's checks must be included in the $5,000 aggregation of checks deposited on any one banking day that are subject to the next-day availability requirement. (See § 229.13(a).)

b. Revising the heading "Deposit at Staffed Teller Station" and the first paragraph under that heading.

Deposits Made to an Employee of the Depositary Bank

In most cases, next-day availability of the proceeds of checks subject to this section is conditioned on the deposit of these checks in person to an employee of the depositary bank. If the deposit is not made to an employee of the depositary bank on the premises of such bank, the proceeds of the deposit must be made available for withdrawal by the start of business on the second business day after deposit, under paragraph (c)(2) of this section. For example, second-day availability rather than next-day availability would be allowed for deposits of checks subject to this section made at a proprietary ATM (and at a nonproprietary ATM under the permanent schedule), night depository, through the mail or a lock box, or at a teller station staffed by a person that is not an employee of the depositary bank. Second-day availability may also be allowed for deposits picked up by an employee of the depositary bank at the customer's premises; such deposits would be considered made upon receipt at the branch or other location of the depositary bank.

* * * * *

c. Removing the heading "Fees for Withdrawals" and the paragraph appearing under it.

d. In the fifth paragraph under the heading "Special Deposit Slips," revising the second sentence.

Special Deposit Slips

* * * * *

* * * If a bank only provides the special deposit slips upon the request of a depositor, however, the teller must advise the depositor of the availability of the special deposit slips, or the bank must post a notice advising customers that the slips are available upon request. * * *

13. The Commentary to § 229.11(c) is amended by revising the first sentence to read as follows:

SECTION 229.11 TEMPORARY AVAILABILITY SCHEDULE

* * * * *

(c) Nonlocal checks. Under the temporary schedule, funds deposited by nonlocal checks must be made available for withdrawal not later than the seventh business day following the banking day the funds are deposited, except in the case of deposits in accounts of banks located outside the 48 contiguous states. * * *

* * * * *

14. The Commentary to § 229.13(b) is amended by adding a new sentence after the second sentence in paragraph (b) introductory text to read as follows:

SECTION 229.13 EXCEPTIONS

* * * * *

(b) Large Deposits. * * * When the large deposit exception is applied to deposits composed of both local and

nonlocal checks, the depositary bank has the discretion to choose the portion of the deposit to which it applies the exception.

* * *

* * * * *

15. The Commentary to § 229.16 is amended by adding two new paragraphs to paragraph (a) and adding a new paragraph at the end of paragraph (b) to read as follows:

SECTION 229.16 SPECIFIC AVAILABILITY POLICY DISCLOSURE

(a) General. * * *

The disclosure must reflect the policy and practice of the bank regarding availability as to most accounts and most deposits into those accounts. In disclosing the availability policy that it follows in most cases, a bank may provide a single disclosure that reflects one policy to all its transaction account customers, even though some of its customers may receive faster availability than that reflected in the policy disclosure. Thus, a bank need not disclose to some customers that they receive faster availability than indicated in the disclosure. If, however, a bank has a policy of imposing delays in availability on any customers longer than those specified in its disclosure, those customers must receive disclosures that reflect the longer applicable availability periods.

A bank may disclose that funds are "available for withdrawal" on a given day notwithstanding the fact that the bank uses the funds to pay checks received before that day. For

example, a bank may disclose that its policy is to make funds available from deposits of local checks on the second business day following the day of deposit, even though it may use the deposited funds to pay checks prior to the second business day; the funds used to pay checks in this example are not available for withdrawal until the second business day after deposit because the funds are not available for all uses until the second business day. (See the definition of "available for withdrawal" in § 229.2(d).)

(b) Content of Specific Policy Disclosure. * * *

A bank that provides availability based on when the bank generally receives credit for deposited checks need not disclose the time when a check drawn on a specific bank will be available for withdrawal. Instead, the bank may disclose the categories of deposits that must be available on the first business day after the day of deposit (deposits subject to § 229.10) and state the other categories of deposits and the time periods that will be applicable to those deposits. For example, a bank might disclose the four-digit Federal Reserve routing symbol for local checks and indicate that such checks as well as certain nonlocal checks will be available for withdrawal on the first or second business day following the day of deposit, depending on the location of the particular bank on which the check is drawn, and disclose that funds from all other checks will be available on the second or third business day. The bank must also disclose that the

customer may request a copy of the bank's detailed schedule that would enable the customer to determine the availability of any check and must provide such schedule upon request. A change in the bank's detailed schedule would not trigger the change in policy disclosure requirement of § 229.18(e).

* * * * *

Section 229.19 -- [Amended]

16. The Commentary to § 229.19 is amended as follows:

a. Adding a new sentence after the third sentence of paragraph (a) introductory text and removing the last sentence of the last paragraph and adding a new paragraph at the end thereof.

(a) <u>When Funds Are Considered Deposited</u>. * * * Funds deposited to a deposit box in a bank lobby that is accessible to customers only during regular business hours are generally considered deposited when placed in the lobby box; a bank may, however, treat deposits to lobby boxes the same as deposits to night depositories (as provided in § 229.19(a)(3)), provided a notice appears on the lobby box informing the customer when such deposits will be considered received. * * *

* * * * *

A bank is not required to remain open until 2:00 p.m. If a bank closes before 2:00 p.m., deposits received after the closing may be considered received on the next banking day. Further, as § 229.2(f) defines the term "banking day" as the

portion of a business day on which a bank is open to the public for substantially all of its banking functions, a day, or a portion of a day, is not necessarily a banking day merely because the bank is open for only limited functions, such as keeping drive-in or walk-up teller windows open, when the rest of the bank is closed to the public. For example, a banking office that usually provides a full range of banking services may close at 12:00 noon but leave a drive-in teller window open for the limited purpose of receiving deposits and making cash withdrawals. Under those circumstances, the bank is considered closed and may consider deposits received after 12:00 noon as having been received on the next banking day. The fact that a bank may reopen for substantially all of its banking functions after 2:00 p.m., or that it continues its back office operations throughout the day, would not affect this result. A bank may not, however, close individual teller stations and reopen them for next-day's business before 2:00 p.m. during a banking day.

b. In paragraph (e), revising the second paragraph and adding a third paragraph.

(e) Holds on other funds. * * *

This paragraph clarifies that if a customer deposits a check in an account (as defined in § 229.2(a)), the bank may not place a hold on any of the customer's funds so that the funds that are held exceed the amount of the check deposited or the total amount of funds held are not made available for withdrawal

within the times required in this subpart. For example, if a bank places a hold on funds in a customer's nontransaction account, rather than a transaction account, for deposits made to the customer's transaction account, the bank may place such a hold only to the extent that the funds held do not exceed the amount of the deposit and the length of the hold does not exceed the time periods permitted by this regulation.

These restrictions also apply to holds placed on funds in a customer's account (as defined in § 229.2(a)) if a customer cashes a check at a bank (other than a check drawn on that bank) over the counter. The regulation does not prohibit holds that may be placed on other funds of the customer for checks cashed over the counter, to the extent that the transaction does not involve a deposit to an account. A bank may not, however, place a hold on any account when an on us check is cashed over the counter. On us checks are considered finally paid when cashed (see U.C.C. § 4-213(1)(a)).

17. The Commentary to § 229.20(c) is revised to read as follows:

SECTION 229.20 RELATION TO STATE LAW

* * * * *

(c) Standards for preemption. This section describes the standards the Board will use in making determinations on whether federal law will preempt state laws governing funds availability. A provision of state law is considered inconsistent with federal law if it permits a depositary bank to make funds available to a

customer in a longer period of time than the maximum period permitted by the Act and this regulation. For example, a state law that permits a hold of four business days or longer for local checks permits a hold that is longer than that permitted under the Act and this regulation, and therefore is inconsistent and preempted. State availability schedules that provide for availability in a shorter period of time than required under Regulation CC supersede the federal schedule.

Under a state law, some categories of deposits could be available for withdrawal sooner or later than the time required by this subpart, depending on the composition of the deposit. For example, the Act and this regulation (§ 229.10(c)(1)(vii)) require next-day availability for the first $100 of the aggregate deposit of local or nonlocal checks on any day, and a state law could require next-day availability for any check of $100 or less that is deposited. Under the Act and this regulation, if either one $150 check or three $50 checks are deposited on a given day, $100 must be made available for withdrawal on the next business day, and $50 must be made available in accordance with the local or nonlocal schedule. Under the state law, however, the two deposits would be subject to different availability rules. In the first case, none of the proceeds of the deposit would be subject to next-day availability; in the second case, the entire proceeds of the deposit would be subject to next-day availability. In this example, because the state law would, in

some situations, permit a hold longer than the maximum permitted by the Act, this provision of state law is inconsistent and preempted in its entirety.

In addition to the differences between state and federal availability schedules, a number of state laws contain exceptions to the state availability schedules that are different from those provided under the Act and this regulation. The state exceptions continue to apply only in those cases where the state schedule is shorter than or equal to the federal schedule, and then only up to the limit permitted by the Regulation CC schedule. Where a deposit is subject to a state exception under a state schedule that is not preempted by Regulation CC and is also subject to a federal exception, the hold on the deposit cannot exceed the hold permissible under the federal exception in accordance with Regulation CC. In such cases, only one exception notice is required, in accordance with § 229.13(g). This notice need only include the applicable federal exception as the reason the exception was invoked. For those categories of checks for which the state schedule is preempted by the federal schedule, only the federal exceptions may be used.

State laws that provide maximum availability periods for categories of deposits that are not covered by the Act would not be preempted. Thus, state funds availability laws that apply to funds in time and savings deposits are not affected by the Act or this regulation. In addition, the availability schedules of

several states apply to "items" deposited to an account. The term "items" may encompass deposits, such as nonnegotiable instruments, that are not subject to the Regulation CC availability schedules. Deposits that are not covered by Regulation CC continue to be subject to the state availability schedules. State laws that provide maximum availability periods for categories of institutions that are not covered by the Act would also not be preempted. For example, a state law that governs money market mutual funds would not be affected by the Act or this regulation.

Generally, state rules governing the disclosure or notice of availability policies applicable to accounts are also preempted, if they are different from the federal rules. Nevertheless, a state law requiring disclosure of funds availability policies that apply to deposits other than "accounts," such as savings or time deposits, are not inconsistent with the Act and this subpart. Banks in these states would have to follow the state disclosure rules for these deposits.

* * * * *

Section 229.30 -- [Amended]

18. The Commentary to § 229.30 is amended as follows:

a. In paragraph (a), under the fourth numbered example, adding a new sentence to the end of the third paragraph and adding a new sentence to the end of the eighth

paragraph.

(a) Return of checks. * * *

Examples

* * * * *

4. * * *

* * * If a paying bank returns a check on its banking day of receipt without paying for the check, as permitted under U.C.C. § 4-302(a), and receives settlement for the returned check from a returning bank, it must promptly pay the amount of the check to the collecting bank from which it received the check.

* * * * *

* * * Also, a paying bank is not responsible for failure to make expeditious return to a party that has breached a presentment warranty under U.C.C. § 4-207(1), notwithstanding that the paying bank has returned the check. (See Commentary to § 229.30(a).)

* * * * *

b. In paragraph (b), revising the fourth sentence of the second paragraph and adding two new sentences to immediately follow, and revising the first sentence of the third paragraph.

(b) Unidentifiable depositary bank. * * *

* * * A paying bank returning a check under this paragraph to a bank that has not agreed to handle the check expeditiously must advise that bank that it is unable to identify

the depositary bank. This advice must be conspicuous, such as a stamp on each check for which the depositary bank is unknown if such checks are commingled with other returned checks, or, if such checks are sent in a separate cash letter, by one notice on the cash letter. The returned check may not be prepared for automated return. * * *

The sending of a check to a bank that handled the check for forward collection under this paragraph is not subject to the requirements for expeditious return by the paying bank. * * *

* * * * *

c. Revising paragraph (f) introductory text.

(f) Notice in Lieu of Return. A check that is lost or otherwise unavailable for return may be returned by sending a legible copy of both sides of the check or, if such a copy is not available to the paying bank, a written notice of nonpayment containing the information specified in § 229.33(b). The copy or written notice must clearly indicate it is a notice in lieu of return and must be handled in the same manner as other returned checks. Notice by telephone, telegraph, or other electronic transmission, other than a legible facsimile or similar image transmission of both sides of the check, does not satisfy the requirements for a notice in lieu of return. The requirement for a writing and the indication that the notice is a substitute for the returned check is necessary so that the returning and depositary banks are informed that the notice carries value.

Notice in lieu of return is permitted only when a bank does not have and cannot obtain possession of the check or must retain possession of the check for protest. A check is not unavailable for return if it is merely difficult to retrieve from a filing system or from storage by a keeper of checks in a truncation system. A notice in lieu of return may be used by a bank handling a returned check that has been lost or destroyed, including when the original returned check has been charged back as lost or destroyed as provided in § 229.35(b). A bank using a notice in lieu of return gives a warranty under § 229.34(a)(4) that the original check has not been and will not be returned.

* * * * *

Section 229.31 -- [Amended]

19. The Commentary to § 229.31 is amended as follows:

a. In paragraph (b), revising the last sentence of the introductory text and revising the last paragraph.

(b) Unidentifiable depositary bank. * * * In the limited cases where the returning bank cannot identify the depositary bank, the returning bank may send the returned check to a returning bank that agrees to handle the returned check for expeditious return under § 229.31(a), or it may send the returned check to a bank that handled the check for forward collection, even if that bank does not agree to handle the returned check expeditiously under § 229.31(a).

* * * * *

As in the case of a paying bank returning a check under § 229.30(b), a returning bank returning a check under this paragraph to a bank that has not agreed to handle the check expeditiously must advise that bank that it is unable to identify the depositary bank. This advice must be conspicuous, such as a stamp on each check for which the depositary bank is unknown if such checks are commingled with other returned checks, or, if such checks are sent in a separate cash letter, by one notice on the cash letter. The returned check may not be prepared for automated return.

b. In paragraph (c), revising the parenthetical at the end of the second paragraph.

(c) Settlement. * * *

* * * (See § 229.36(d) and Commentary to § 229.35(b).)

* * * * *

c. In paragraph (f), adding a new sentence before the parenthetical phrase.

(f) Notice in lieu of return. * * * Notice in lieu of return is permitted only when a bank does not have and cannot obtain possession of the check or must retain possession of the check for protest. A check is not unavailable for return if it is merely difficult to retrieve from a filing system or from storage by a keeper of checks in a truncation system. * * *

20. The Commentary to § 229.32(a) is amended by redesignating

item 2(iii) as 2(iv), adding a new item 2(iii), and adding a new paragraph after the last paragraph to read as follows:

SECTION 229.32 DEPOSITARY BANK'S RESPONSIBILITY FOR RETURNED CHECKS

(a) Acceptance of returned checks. * * *

2. * * *

(iii) The depositary bank must accept returned checks at the address in its indorsement and at an address associated with its routing number in the indorsement if the written address in the indorsement and the address associated with the routing number in the indorsement are not in the same check processing region. Under §§ 229.30(g) and 229.31(g), a paying or returning bank may rely on the depositary bank's routing number in its indorsement in handling returned checks and is not required to send returned checks to an address in the depositary bank's indorsement that is not in the same check processing region as the address associated with the routing number in the indorsement.

* * * * *

Under § 229.33(d), a depositary bank receiving a returned check or notice of nonpayment must send notice to its customer by its midnight deadline or within a longer reasonable time.

* * * * *

Section 229.33 -- [Amended]

21. The Commentary to § 229.33 is amended as follows:

a. In paragraph (a), adding a new paragraph at the end thereof.

(a) Requirement. * * *

Unless the returned check is used to satisfy the notice requirement, the requirement for notice is independent of and does not affect the requirements for timely and expeditious return of the check under § 229.30 and the U.C.C. (See § 229.30(a).) If a paying bank fails both to comply with this section and to comply with the requirements for timely and expeditious return under § 229.30 and the U.C.C. and Regulation J (12 CFR Part 210), the paying bank shall be liable under either this section or such other requirements, but not both. (See § 229.38(b).) A paying bank is not responsible for failure to give notice of nonpayment to a party that has breached a presentment warranty under U.C.C. section 4-207(1), notwithstanding that the paying bank may have returned the check. (See U.C.C. §§ 4-207(1) and 4-302.)

b. In paragraph (d), revising the first sentence.

(d) Notification to Customer. This paragraph requires a depositary bank to notify its customer of nonpayment upon receipt of a returned check or notice of nonpayment, regardless of the amount of the check or notice. * * *

22. The Commentary to § 229.34(a) is amended by revising the

first and last sentence thereof to read as follows:

SECTION 229.34 WARRANTIES BY PAYING BANK AND RETURNING BANK

(a) Warranty of returned checks. This paragraph includes warranties that a returned check, including a notice in lieu of return, was returned by the paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, within the deadline under the U.C.C., Regulation J, or § 229.30(c); that the paying or returning bank is authorized to return the check; that the returned check has not been materially altered; and that, in the case of notice in lieu of return, the original check has not and will not be returned (see Commentary to § 229.30(f)). * * * These warranties do not apply to checks drawn on the United States Treasury, to Postal Service money orders, or to checks drawn on a state or a unit of general local government that are not payable through or at a bank (see § 229.42).

* * * * *

Section 229.35 -- [Amended]

23. The Commentary to § 229.35 is amended as follows:

a. In paragraph (a), adding two sentences to the end of the fourth paragraph, revising the first two sentences in the fifth paragraph, and adding a sentence to the end of the last paragraph.

(a) Indorsement Standards. * * *

* * * * *

* * * Depositary banks should not include information that can be confused with required information. For example, a nine-digit zip code could be confused with the nine-digit routing number.

A depositary bank is not required to place a street address in its indorsement; however, a bank may want to put an address in its indorsement in order to limit the number of locations at which it must accept returned checks. In instances where this address is not consistent with the routing number in the indorsement, the depositary bank is required to accept returned checks at a branch or head office consistent with the routing number. Banks should note, however, that § 229.32 requires a depositary bank to accept returned checks at the location(s) it accepts forward collection checks. * * * * * * * * *

* * * The standard requires collecting and returning banks to indorse the check for tracing purposes.

b. In paragraph (b), adding four sentences to the end of the fifth paragraph and adding a new paragraph after the fifth paragraph.

(b) <u>Liability of bank handling check</u>. * * * * * * * * *

* * * Nor does this paragraph affect a collecting bank's accountability under U.C.C. §§ 4-211(2) and (3) and 4-213(3). A collecting bank becomes accountable upon receipt of

final settlement as provided in the foregoing U.C.C. sections. The term "final settlement" in §§ 229.31(c), 229.32(b), and 229.36(d) is intended to be consistent with the use of the term "final settlement" in the U.C.C. (e.g., U.C.C. §§ 4-211, 4-212, and 4-213). (See also § 229.2(cc) and Commentary.)

This paragraph also provides that a bank may have the rights of a "holder" based on the handling of the check for collection or return. A bank may become a holder or a holder in due course regardless of whether prior banks have complied with the indorsement standard in § 229.35(a) and Appendix D.

* * * * *

24. The Commentary to § 229.37 is amended by revising the second sentence of the first paragraph and revising the second paragraph to read as follows:

SECTION 229.37 VARIATIONS BY AGREEMENT

* * * To achieve consistency, the official comment to U.C.C. § 4-103(1) (which in turn follows U.C.C. § 1-201(3)) should be followed in construing this section. * * *

The Board has not followed U.C.C. § 4-103(2), which permits Federal Reserve regulations and operating letters, clearinghouse rules, and the like to apply to parties that have not specifically assented. Nevertheless, this section does not affect the status of such agreements under the Uniform Commercial Code.

* * * * *

25. In the Commentary to § 229.38(d), the first two sentences of the second paragraph are revised to read as follows:

SECTION 229.38 LIABILITY

* * * * *

(d) Responsibility for back of check. * * *

The paying bank or, in the case of a check payable through the paying bank and payable by another bank, the bank by which the check is payable, is responsible for the condition of the check when it is issued by it or its customer. (It would not be responsible for a check issued by a person other than such a bank or customer.) * * *

* * * * *

26. In the Commentary to Appendix C, under the heading "Models C-1 Through C-7 Generally," a new paragraph is added after the fifth paragraph to read as follows:

APPENDIX C

* * * * *

Models C-1 Through C-7 Generally

* * * * *

Banks that have used model forms C-1, C-2, or C-3 or have used forms C-4, C-5, C-6, or C-7 (which give social security benefits and payroll payments as examples of preauthorized credits available the day after deposit) and that at the same time follow Treasury regulations (31 CFR Part 210) and ACH association rules requiring that these credits be made available

on the day the bank receives the funds are protected from civil liability under § 229.21(e). Such banks are encouraged to disclose same-day availability for those electronic payments when reordering supplies of forms.

* * * * *

By order of the Board of Governors of the Federal Reserve System, March 31, 1989.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

Attachment B to TB 9-1

Federal Reserve System

12 CFR Part 229
(Reg. CC; Docket No. R-0648)
RIN 7100-AB01

Availability of Funds and Collection of Checks

Final Rule; August 4, 1989

Rules and Regulations

Federal Register
Vol. 54, No. 149
Friday, August 4, 1989

FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Reg. CC; Docket No. R-0648]

RIN 7100-AB01

Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is publishing amendments to its Regulation CC,

Availability of Funds and Collection of Checks (12 CFR Part 229). The rule changes will alleviate the operational difficulties and additional risks associated with the acceptance for deposit of bank payable through checks.

EFFECTIVE DATE: The effective date for the amendments to § 229.38 of the regulation and commentary is February 1, 1990. The effective date for the amendments to § 229.36 of the regulation and commentary is February 1, 1991.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202/452-3874), Gayle Thompson, Manager (202/452-3917), or Kathleen M. Connor, Senior Financial Services Analyst (202/452-3917), Division of Federal Reserve Bank Operations; Oliver Ireland, Associate General Counsel (202/452-3625), or Stephanie Martin, Attorney (202/452-3198), Legal Division; for the hearing impaired *only:* Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: The Board has adopted two amendments to Regulation CC, which: (1) Require bank payable through checks to be conspicuously labeled with the name, location, and first four digits of the routing number of the bank on which the check is written and the legend "payable through" followed by the name and location of the payable through bank; and (2) Place the risk of loss for return of bank payable through checks being returned by a nonlocal payable through bank on the bank on which such checks are written, to the extent that the return from the nonlocal payable through bank took longer than would have been required if the check had been returned expeditiously by the bank on which it is written. The test for expeditious return would be based on the two-day/four-day test in § 229.30(a)(1) of the regulation.

These amendments will become effective on February 1, 1991, and February 1, 1990, respectively.

Background

As adopted in May 1988, Regulation CC provided that checks written on an account at one bank[1] but payable through another bank were to be considered local or nonlocal under Regulation CC and the Expedited Funds Availability Act ("Act") based on the location of the bank designated as the payable through bank. This treatment of "bank payable through checks" was consistent with the scheme set forth in the Act to permit banks to place longer holds on checks that must be sent to nonlocal banks for collection because such checks generally take longer to collect and return than checks sent to local banks for collection and, therefore, could pose greater risks for depositary banks. In addition, treating the payable through bank as the paying bank would have facilitated the handling of these checks by depositary banks because it would have permitted them to use automated equipment to read the routing number of the payable through bank encoded on a check, which indicates the check processing region in which the payable through bank is located. Availability could have been assigned for the check automatically on the basis of that number.[1]

Shortly after the Board adopted Regulation CC defining the payable through bank as the paying bank and thus allowing bank payable through checks to be treated as local or nonlocal according to the location of the payable through bank, the Credit Union National Association ("CUNA") and one of its member credit unions brought suit asserting that this rule was contrary to the provisions of the Act. The suit asserted that such checks, in particular credit union share drafts, should be treated as local or nonlocal on the basis of the location of the bank on which they are written, rather than the location of the payable through bank. CUNA believed that the treatment of bank payable through checks adopted by the Board would have an adverse effect on the acceptability of these checks as a form of payment because most credit union payable through checks would be treated as nonlocal, even though they would generally be deposited in a bank local to the credit union. CUNA argued that if these checks were generally treated as nonlocal, a large number of credit unions that offer payable through share draft accounts would be disadvantaged.

On July 28, 1988, the U.S. District Court for the District of Columbia ruled that under the language of the Act, payable through checks should be treated as local or nonlocal on the basis of the location of the credit union on which they are written rather than the location of the payable through bank. On August 18, 1988, the Board adopted interim amendments to Regulation CC to implement the court's decision and requested comment on the interim rule pending consideration of a longer term response to the court's interpretation of the Act (53 FR 31290, August 18, 1988). The interim rule applied the court's decision to all bank payable through checks rather than only those written on credit unions.

One hundred fifty-five comments were received on the interim rule. The overwhelming majority of these commenters objected to the treatment of bank payable through checks as local or nonlocal based on the location of the bank on which they are written, asserting that the rule creates operational difficulties and increased risks for depositary banks. Many of the commenters suggested various means of addressing these operational problems and risks.

On November 2, 1988, the Board adopted the interim rule, with minor technical changes, as a final rule, and also published for comment proposed amendments to Regulation CC designed to alleviate the operational difficulties and increased risks resulting from the new rule. (53 FR 44324, 44335, November 2, 1988.) These proposed amendments were based on specific suggestions of the commenters on the interim rule and on subsequent discussions with industry representatives and the Industry Return Item Advisory Group, which includes representatives of commercial banks, savings and loan associations, and credit unions. The Board issued the proposals for comment to gain further information concerning whether the proposals were necessary to facilitate compliance with the revised regulation and to improve the check system by speeding the collection and return of payable through checks, and whether they would impose undue burdens on the banks on which bank payable through checks are written.

The four proposals for which the Board requested comment would:

(1) Require bank payable through checks to bear a routing number in the MICR (Magnetic Ink Character Recognition) line local to the bank on which the checks are written, and to be presentable locally;

(2) Require bank payable through checks to be conspicuously labeled with the name, location, and nine-digit routing number of the bank on which the check is written and the legend "payable through" followed by the name and location of the payable through bank;

Regulation CC defines *bank* to include all depository institutions, including commercial banks, savings and loan associations, and credit unions. A *depositary bank* is defined as the first bank to which a check is transferred. A *paying bank* is the bank by which a check is payable for the purpose of determining whether a check is local or nonlocal for determining availability.

(3) Authorize direct presentment to the bank on which the payable through check is written; and

(4) Place the risk of loss for return of bank payable through checks being returned by a nonlocal payable through bank on the bank on which such checks are written, to the extent that the return from the nonlocal payable through bank took longer than would have been required if the check had been returned expeditiously by the bank on which it is written.

Discussion

The Board received a total of 763 comments from the public on the proposed amendments to Regulation CC.[2] The following table shows the comments received by category of respondent:

Commercial banks and bank holding companies	264
Savings and loan associations	7
Credit unions	451
Trade associations	23
Corporations	5
Government Agencies	3
Members of Congress	10

Generally, commercial bank commenters supported all four proposals, but particularly stressed the need to require that bank payable through checks bear a routing number local to the bank on which such checks are written. Credit union commenters strongly opposed this proposal, as well as the proposal authorizing direct presentment to the banks on which payable through checks are written. Credit union commenters generally did not oppose implementation of the proposal to require bank payable through checks to be conspicuously labeled with specific information related to both the bank on which the check is written and the payable through bank and the proposal to shift the risk of loss to banks issuing payable through checks for return of such checks from nonlocal payable through banks, to the extent that the return of a payable through check from the nonlocal payable through bank took longer than would have been required if the check had been returned expeditiously by the bank on which the check is written. A summary discussion of the Board's analysis of each proposed amendment follows.

Require bank payable through checks to be conspicuously labeled with the name, location, and nine-digit routing number of the bank on which the check is written and the legend "payable through" followed by the name and location of the payable through bank. In order for banks to be able to manually identify payable through checks from other check deposits and determine by visual inspection the appropriate hold, rather than rely on the routing number encoded on the check to determine availability, the Board proposed that certain information pertaining to the payable through bank and the bank on which the check is written must be included on the check.

Other than the routing number of the bank on which the payable through checks are written, the information specified in this proposal is currently required by either existing law or Federal Reserve operating circular.[3] This proposal would clarify that this information is required and would apply to all bank payable through checks, including those checks collected outside the Federal Reserve. It would also require that such labeling be conspicuous, setting a minimum type size standard. In addition, through inclusion in the regulation, liability for noncompliance would be established.

The Board specifically requested comment on the cost savings and operational benefits to depository banks and the costs to banks using payable through checks that would result from adoption of this proposal. Of the 295 comment letters addressing this issue, 214 commenters supported this proposal and 81 opposed it.

The commenters in support of the conspicuous labeling requirement stated that identification would aid in compliance with the availability requirements of Regulation CC. They noted that the additional information could facilitate manual handling of payable through checks, although it would not permit their identification on an automated basis. The Bank Administration Institute stated, "While this proposal would not appreciably reduce risk, it would aid in compliance with Regulation CC hold rules. According to a recent Bank Administration Institute study, over 60 percent of financial institutions have adopted 'case-by-case' hold policies. Under such a policy, the depository bank applies holds in selected cases, rather than as a general rule. Under a case-by-case policy, the employee placing the hold must be able to identify local and nonlocal checks accurately by visual inspection. Conspicuous labeling as described in this proposal would aid in this process. Full identification of the payable through bank by name and location would also assist in resolving exceptions in interbank check clearings, such as misrouted items." The Independent Bankers Association of America indicated that community bankers would gain immediate operational benefits from this proposal.

A small number of commenters noted that this proposal would prove helpful when processing damaged checks. Wells Fargo Bank, San Francisco, California, stated, "The alternative of printing identifying information on the face of the check helps when dealing with checks where the MICR line is damaged or destroyed * * *." For example, the name and location of the payable through bank may be needed in those cases where the routing number on the check cannot be properly read.

The majority of commenters that supported the conspicuous labeling proposal indicated that they preferred adoption of the proposal to require payable through checks to bear a routing number in the MICR line local to the bank on which the checks are written. Marine Midland Bank, New York, New York, commented, "This alternative is better than no change in the form in which payable through drafts are issued, but it does nothing to reduce the unreasonably high operational costs of identifying bank payable through checks."

Some credit union commenters stated that this proposal was not objectionable provided they would be given a reasonable period of time to handle the reprinting of their share drafts. The Credit Union National Association generally supported a revised version of this proposal. CUNA commented that "only the first four digits of the credit union's routing number should be required. The additional digits will not facilitate identification of items as local or nonlocal; in fact, they will only further clutter the drawee area and complicate identification by consumers and bank tellers. Inclusion of all nine digits will also promote direct presentment of payable through share drafts to credit unions * * *." The

[2] This number does not include comment letters from Federal Reserve Banks and duplicate comment letters from the same bank.

[3] See U.C.C. § 3-120, *Engine Parts, Inc. v. Citizens Bank of Clovis*, 92 N.M. 37, 582 P.2d 809, 23 UCC Rep. Serv. 1246 (1978), and *Phelan v. University National Bank*, 85 Ill. App. 2d 56, 229 N.E.2d 374, 4 UCC Rep. Serv. 635 (1967). The Federal Reserve Operating Circular on the Collection of Cash Items and Returned Checks, as revised effective July 17, 1989, states that banks should not send to a Reserve Bank for forward collection a check that "does not set forth on its face the name of the paying bank and a city and state address of the bank that is located in (1) the same Reserve Bank check processing region as, and (2) a Reserve Bank availability zone that provides the same (or slower) availability than the address associated with the routing number in magnetic ink on the item."

Independent Bankers Association of America supported this proposal, but noted, "Most community bankers indicated that including another nine digit routing number on the face of the check could result in unnecessary confusion for the teller making the identification."

The Board had noted, in its request for comment on this proposal, that an ancillary benefit to requiring that the nine-digit routing number of the bank on which the check is written be printed on the face of the check is that it would provide information needed to establish arrangements for automated clearinghouse (ACH) transfers to or from an account—information that is generally obtained from a check of the customer requesting the ACH service. The Board believed that the identification on the face of the check of the routing number of the bank on which the check is written would facilitate sending ACH transfers to the account-holding bank rather than to the payable through bank, which generally rejects the transfer. A major payable through bank, however, indicated to Board staff that it handles ACH transfers for a number of credit unions for which it also performs payable through processing and that inclusion of the nine-digit routing number of the credit union could cause ACH transfers to be misdirected to the credit union.

Inclusion of only the first four digits of the routing number of the bank on which the payable through check is written would be sufficient to permit depositary bank personnel to assign local or nonlocal availability to these checks because these digits identify the check processing region in which the bank on which the check is written is located. This would eliminate the need to refer to a list of cities and towns in the depositary bank's check processing region to determine if the location of the bank on which the check is written is local for purposes of Regulation CC. The Board believes that requiring the identification of the entire nine-digit routing number, rather than only the first four digits, on the face of bank payable through checks would not provide any incremental significant benefits, and has modified the proposal to require inclusion of only the first four digits of the routing number of the bank on which the check is written on the face of the check.

CUNA also stated, "Because of the advantage to consumers, CUNA urges a requirement that the drawee area of all checks contain the first four digits of the drawee's routing number." The Board does not believe it is necessary that the requirement apply to all checks because tellers and consumers can determine local or nonlocal availability by referring to the first four digits of the routing number in the MICR line for all checks other than bank payable through checks.

A few commenters suggested that the Board should specify where the required information is to be placed on the face of the check. The Board has provided in the commentary to § 229.36 that the required information is deemed conspicuous if it is located in the title plate [4] on the check.

The Board proposed that the rule become effective one year after adoption. A small number of commenters discussed the appropriate effective date for this proposal. Bank commenters either supported the proposed one year implementation period or requested an effective date of less than one year. Credit union commenters generally stated that they would need additional time for their members to use existing check stock and reorder the new checks. The Credit Union National Association stated, "A more reasonable effective date of this proposal would be two years after adoption of the amendment to allow credit union members to use their current supply of share drafts." While on average customers reorder checks annually, additional time would allow for the check printers to make title plates and for credit union members to reorder checks. The Board believes that eighteen months will provide sufficient time for both the manufacture of new plates and check reorders.

The 81 commenters that opposed the conspicuous labeling proposal stated that it encourages manual handling. A number of commenters indicated that they opposed this proposal because they believed that the proposal requiring a local routing number in the MICR line is a better solution. First Virginia Banks, Inc., Falls Church, Virginia, stated, "First Virginia does not favor this proposal as it places the burden of recognizing payable through checks on the teller. This proposal invites human error and Regulation CC violations and will only act to delay item processing, because these checks will have to be handled as exception items."

Maryland National Bank, Baltimore, Maryland, stated that this proposal "does not permit the automated processing of payable through draft checks which is critical to maintaining the integrity of the payment system. This would create an indeterminate degradation of customer service at the branch level of financial institutions and a corresponding increase in expenses due to the visual inspection required which would be eventually passed on to the customer."

A small number of commenters discussed the costs of this proposal. These commenters indicated that without the concurrent adoption of the proposal requiring a local routing number in the MICR line, the costs to banks would be prohibitive because they would have to manually process the payable through checks. Bank One, Milwaukee, Wisconsin, stated, "* * * sight review would significantly increase a bank's processing costs because it would require adding employees to the teller proof or transit operation." Bank One estimated $225,000 per year as "the labor expense we would incur if we have to visually inspect all items deposited, and manually make float adjustments for share draft or payable through items."

A number of commenters expressed concern that the labeling requirement could have an adverse impact on the acceptance of payable through drafts. The Chicago Clearinghouse Association, Chicago, Illinois, commented, "This requirement would make obvious visual distinction between a regular check and a payable through check and would be detrimental to institutions using payable through checks. The distinction may create negotiability problems with merchants and consumers who may not understand the reasons for such obvious labels. Because of the label, some merchants may not honor payable through checks as cash items." The specified information is already required, however, except for the first four digits of the routing number, which is necessary for the depositary bank to determine availability. Consequently, the Board does not believe the labeling requirement will cause negotiability problems for payable through checks.

The requirement that specified information be printed on the face of the check does not address the potential risks of bank payable through checks becoming attractive vehicles for fraud because it does not accelerate the collection of payable through checks. Under this proposal, the bank on which the payable through checks are written or its customers would incur costs to reissue its checks. Given an eighteen month lead time, the cost of reissuance should be minimal. This proposal would not require any bank to move its

[4] The title plate appears in the lower left quadrant on the face of the check, below the amount line and above the memo line, and generally includes the name and location of the paying bank.

payable through check processing to a different bank.

The Board is adopting an amendment to Regulation CC that would require bank payable through checks to be conspicuously labeled with the name, location, and first four digits of the routing number of the bank on which the check is written and the legend "payable through" followed by the name and location of the payable through bank. This rule becomes effective eighteen months after final adoption.

Place the risk of loss for return of bank payable through checks being returned by a nonlocal payable through bank on the bank on which such checks are written, to the extent that the return from the nonlocal payable through bank took longer than would have been required if the check had been returned expeditiously by the bank on which it is written. Commenters on the interim rule expressed concern regarding the potential risk of losses and increased exposure to fraud for depositary banks resulting from the revised rule. They indicated that checks considered local for determining availability should also be considered local for determining whether the checks are returned expeditiously so that the risks to depositary banks would not be increased by the revised rule. Two hundred eighty comment letters addressed this proposal. Two hundred twelve commenters supported this proposal and 68 commenters opposed the proposal.

The commenters in support of this proposal stated that it would assign risk in the payment system to the appropriate cause of that risk. The Alamo Savings & Loan Association, San Antonio, Texas, stated, "Even if none of the other proposed amendments are approved, this one must be, because it is inappropriate to allow issuers of 'payable through' checks to accrue the benefits of the definition of local checks from an availability standpoint, but not be responsible for liabilities inherent in the delayed return of unpaid checks from nonlocal 'payable through' banks." The Citizens and Southern Georgia Corporation, Atlanta, Georgia, commented, "It is reasonable and fair to place the risk of loss on the institution responsible for delaying the return process beyond the time normally required for local checks."

In an effort to determine the risks confronting a large regional bank due to the adoption of the rule establishing the bank on which a payable through check is written as the paying bank for determining funds availability, Sovran Financial Corporation, Norfolk, Virginia, conducted an extensive survey of payable through checks in June and July, 1988. Sovran explained, "From the survey, we determined that Sovran—in the states of Maryland, the District of Columbia, and Virginia would process nearly $1 billion a year of payable through items drawn on one of the two major national processors of such items. We projected the annual volume of these items to be 10.2 million. Visual inspection of these items disclosed that almost one half are issued by geographically local institutions. However, because the payable through bank—or the processing bank—has the opportunity to return the items to us in the Board's prescribed nonlocal time frame, the question of whether the issuing bank is geographically local is irrelevant. We applied the actual rate of dishonor for these items, which we had tracked over a two year period, to the dollar and volume data gathered. We determined that *at a minimum*, based on a one day delay (we make the funds available to the customer in three days, but we receive the return on the fourth day) our annual exposure from these items would be $9 million."

The majority of the bank commenters that supported the proposal shifting the risk of loss to the bank on which the payable through check is written recommended that this proposal should be adopted immediately as an interim measure until the proposal requiring a local routing number in the MICR line could be implemented. The Citywide Bank of Denver, Denver, Colorado, stated, "Until such time as (the proposal requiring a local routing number in the MICR line) can be fully implemented, our bank strongly recommends your (proposal shifting the risk of loss to the bank on which the payable through check is written) * * * be instituted for the protection of all depositary banks. There does not seem to be a time factor requirement to implement this approach and the cost factor on the norm, would be minimal."

Some bank commenters that supported this proposal expressed concern about the practice of claiming a loss under this proposal. The Chicago Clearinghouse Association commented, "We are in favor of assigning risk in the payment system to the appropriate cause of that risk, but are concerned about the practicality of claiming a loss under the current proposal. With so many schedules for availability and collection, proving responsibility for loss will be difficult. This makes it unlikely that any but large-dollar losses will be contested. We suggest that a method be developed within the normal return system for a depositary bank to claim a loss and receive compensation." Prime Bank, Grand Rapids, Michigan, stated, "The Federal Reserve should take measures to accommodate these banks who have suffered such liability and losses to easily recoup these losses from the payable bank."

Some credit unions expressed limited support for the proposal shifting the risk of loss to the bank on which a payable through check is written. The Family Community Credit Union, Charles City, Iowa, commented that this proposal "is also a proposal that could be workable for credit unions. Either one of these proposals (the conspicuous labeling proposal or the proposal shifting the risk of loss to the bank on which the payable through check is written) would not require the expense, equipment and staff that the other two would require."

The Chase Manhattan Corporation, New York, New York, a major payable through processor, stated, "Of the four approaches the Board has proposed, Chase prefers this approach because it would provide an effective means of protecting depositary banks from the risk of loss for return of bank payable through checks without dismantling the present efficient and cost effective payable through system."

Some commenters suggested that the proposal be modified to limit the risk that could be allocated to the bank on which the check is written. The Credit Union National Association generally supported a modified version of the proposal. CUNA commented, "Credit unions should only assume actual direct losses caused by a delayed return from a payable through bank; that is, only losses of amounts that exceed the $100 next-day availability rule and are under the $2,500 amount covered by the large-dollar item notice requirements of the Regulation."

Under the proposed rule to shift the risk of loss, the bank on which the check is written would only be responsible for losses that occurred between the time that the check would have been required to be returned if returned expeditiously by that bank and the actual time that it takes to return the check from the payable through bank. If the payable through bank complies with the current notice of nonpayment requirement for returned checks of $2,500 or more and the depositary bank takes action to minimize its risk upon receipt of the notice, no loss should occur that could be allocated to the bank on which the check is written. If the depositary bank takes no action upon receipt of the notice, it may be liable for losses incurred under the liability provisions of § 229.38(a). Thus, the Board does not believe it is necessary to modify the rule

to address CUNA's suggestion that liability should only apply to those checks that are less than $2,500 and thus not covered by the notice of nonpayment requirements.

CUNA also suggested that the allocation of liability be limited to only those amounts that exceed the $100 next-day availability rule. The Act and Regulation CC require depositary banks to provide next-day availability for the first $100 of the aggregate amount of a customer's check deposits made during a banking day. The proposed rule would only shift the risk of loss to the bank on which the check is written in cases where the loss would not have occurred if the check had been returned under the local time frame. If losses occurred because the depositary bank made funds available for withdrawal before it could learn of a local return, such losses would not be shifted to the bank on which the payable through check is written. In addition, because a customer's check deposit may include a mixture of payable through checks and other checks, the Board does not believe it would be appropriate to release the bank on which the payable through check is written from liability for the first $100 of a day's deposit.

The Board had specifically requested comment on what standard(s) should be applied to determine whether the return from a nonlocal payable through bank took longer than would have been required if the check had been returned expeditiously by the bank on which the check is written. Regulation CC requires banks to return checks expeditiously. It allows banks to utilize two tests to determine whether a check has been returned expeditiously. Under the two-day/four-day test, a check is returned expeditiously if a local check is received by the depositary bank on or before the second business day after the banking day on which the check was presented to the paying bank or if a nonlocal check is received by the depositary bank on or before the fourth business day after the banking day on which the check was presented to the paying bank. Under the forward collection test, a check is returned expeditiously if a paying bank sends the returned check in a manner that would ordinarily be used by a bank in the paying bank's community to collect a check drawn on the depositary bank. Generally, this test would be satisfied if a transportation method or collection path is used for returns that is comparable to that used for forward collection.

Several bank commenters indicated concern over the practicality of claiming a loss under the proposal, indicating that it would be particularly difficult to prove responsibility for loss under the forward collection test. Several credit union commenters, including CUNA, suggested that both tests be applicable. The Board believes that the two-day/four-day test provides a measurable standard to ascertain whether the return of the payable through check is expeditious. In contrast, the determination of whether return of a check is expeditious under the forward collection test is made based on the manner by which the paying bank returned the check, rather than the time within which the depositary bank received the return. Since a payable through bank nonlocal to the bank on which the check is written would not use the same manner of return as that used by the bank on which the check is written to collect checks, the forward collection test could not be used as a standard for expeditious return by the payable through bank.

Bank commenters opposed to the proposal shifting the risk of loss to the bank on which the payable through check is written stated that this proposal does not address the operational problem of identifying payable through checks. Eastover Bank for Savings, Jackson, Mississippi, stated, "Shifting the risk of loss is not enough. This will simply lead to many operational difficulties in identifying these checks and will not aid in reaching the goal of a more speedy check collection and return processing system." First Virginia Banks commented, "First Virginia does not favor this proposal, as it will only serve to increase Late Return Claims, litigation expenses, and does not allow for expedited processing of these items."

A number of credit union commenters that opposed the proposal expressed concern about its implementation. The Southern Nevada State Savings & Credit Union, Las Vegas, Nevada, described this proposal as complicated and unmanageable. It commented, "* * * strict time limits would have to be imposed on the receiving banks as well as a detailed record keeping, timed, system that would record the flow of the items. Otherwise, anytime there was A DISPUTE for a loss, we've never had one in 20 years, the receiving institution could simply claim a delayed prccessing schedule. A tracking mechanism would be required."

A small number of credit union commenters stated that they did not think this proposal was necessary. The Navy Federal Credit Union, Merrifield, Virginia, commented, "We are not aware of any evidence of actual losses which would justify the presumed need. Without further justifications, no change to the liability assignments is recommended." A few credit union commenters indicated that the payable through bank should be responsible for the loss instead of the credit union.

The Board is adopting the proposal shifting risk of loss to the bank on which the payable through check is written. The test for expeditious return under this final rule will be based on the two-day/four-day test under § 229.30(a)(1) of the regulation.

The Board also requested comment on the appropriate lead time for implementation of the proposal. Although CUNA indicated that a one-year lead time would allow credit unions that issue payable through drafts sufficient time to modify their insurance coverage to cover any increased risk of loss, CUNA commented that the risk of loss associated with bank payable through checks is virtually nonexistent. On the other hand, many bank commenters indicated that this proposal should be implemented immediately. The Board believes that insurance coverage can be obtained in less than one year. In any event, variations in the effective date of this proposal should have minimal effect on the banks on which payable through checks are written. Therefore, this proposal will become effective six months after adoption.

Require bank payable through checks to be presentable locally and bear a local routing number in the MICR line. Commenters on the interim rule expressed concern about the operational problems posed by the court ruling and interim amendments. They indicated that the Board should require credit unions to encode their own routing numbers on their checks or that of a local payable through bank.

The Board specifically requested comment on the cost savings to depositary banks and the costs to banks issuing payable through checks so that the benefits and costs of this proposal could be more fully assessed. Seven hundred twenty-two comment letters addressed this proposal. Two hundred eighty-two commenters supported this proposal and 440 commenters opposed this proposal.

The commenters in support of the proposal to require a local routing number in the MICR line, predominantly banks, described it as the only practical solution to their operational problems and risk concerns. Several supporters also noted that the proposal would reduce confusion for the consumer. The American Bankers Association stated, "Currently, there is no practical or comprehensible way to describe to a consumer how to distinguish between

local and nonlocal checks and payable through checks except to advise them generally to inquire when they deposit a payable through check. The proposal will allow consumers simply to refer to the MICR line to ascertain whether a deposit is subject to a local or nonlocal check hold."

Several commenters in support of this proposal discussed how it relates to the intent of Regulation CC. The Independent Bankers Association of America commented, "We believe that requiring a local payable through bank is most consistent with the Act's linkage between the availability of funds and the time it takes to collect and return a check." Great Western Financial Corporation, Beverly Hills, California, stated, "By requiring bank payable through checks to be presentable locally and bear a local routing number in the MICR line, Great Western believes that the problems associated with the acceptance for deposit of payable through checks will be addressed, the intent of Regulation CC will be upheld and the best interests of the consumer will be served."

Continental Bank, Chicago, Illinois, stated, "Any proposal that does not allow banks to rely on the MICR line will slow the automated check clearing process considerably and thus retard the goals set by EFAA. As the Board observes, payable through checks account for less than 3% of the processed check volume * * *. Any proposal that does not allow a bank to rely on the MICR line will slow down the processing of the 97% remainder of the checks which today are being efficiently processed. (This proposal) not only confirms the axiom, 'if it ain't broke, don't fix it,' it also encourages credit unions to process their items in a manner that will enhance the goals of EFAA. * * * (This proposal) thus places the cost of expeditiously processing payable through checks on the segment of the industry that enjoys the benefit, and in addition, encourages high speed automatic processing of checks consistent with the goals of EFAA."

Commenters explained that the primary benefit of this proposal would be to eliminate problems in determining proper availability by allowing banks to rely on the routing number encoded in the MICR line. The Bank Administration Institute stated that this proposal is "the most comprehensive solution to the problem. It reduces risk by providing a local clearing and return mechanism for checks that must be treated as local for check holds. It also simplifies compliance because depository institutions would be able to rely on the routing number to identify the local check processing region, either by visual inspection or automated means." First Virginia Banks stated, "First Virginia favors this proposal as it allows for automated processing and expedites the check collection. It will eliminate as much human intervention as possible and allows payable through checks to be handled in mainstream processing and not as exception items."

Without the ability to rely on the routing number to determine whether a check is local or nonlocal and thus determine the appropriate holds, a bank must develop alternative procedures to identify payable through checks and place the appropriate holds on such checks. These procedures include (1) having the teller identify and outsort payable through checks as they are deposited so that holds can be manually applied; and (2) identifying the routing numbers of nonlocal payable through banks [6] and assigning local availability on an automated basis to all checks destined to these routing numbers.

Bank commenters noted that requiring a local routing number in the MICR line was the only proposal that placed the time and expense of processing payable through checks on the bank on which the checks are written. Branch County Bank, Coldwater, Michigan, commented, "The requirement to make bank payable through checks bear a local routing number is the only one which places the time and expense of processing where it rightly belongs."

Bank commenters stated that it was difficult to estimate the operational cost savings that would result if this proposal were adopted. AmSouth Bank, Birmingham, Alabama, estimated that its annual dollar cost in teller staffing to implement a manual inspection approach to payable through checks would be $6,607,500. Bank One stated, "There is a cost avoidance (through requiring a local routing number in the MICR line) of about $225,000 per year. This is the labor expense we would incur if we have to visually inspect all items deposited, and manually make float adjustments for share draft or payable through items." Citicorp, New York, New York, stated, "As for the costs associated with the proposal, it is practically impossible to provide meaningfully accurate figures; it is not unreasonable, however, to project some figures based on the check collection process itself. For the banking industry nationwide (not including credit unions and the processors), Citicorp estimates that it would take a teller approximately two/three seconds to determine whether or not an item is payable through draft and whether or not it is local based on an examination of the check itself. * * * Factoring in the number of tellers employed, their hours, salary, other benefits and the approximate total number of items processed by all banks in the course of a year, we would project a cost figure of five hundred million dollars * * * for the banking community to comply with the regulation as amended as a result of the *CUNA* suit—absent adoption of the proposed amendments."

This estimate, however, assumes that all banks apply differential holds to deposits of local and nonlocal checks, as permitted in the regulation. According to a study conducted by the Bank Administration Institute, 83 percent of all banks provide immediate or next-day availability with the option to apply holds on a case-by-case or exception basis. The BAI study is corroborated by surveys conducted by trade associations in coordination with the Federal Reserve, which indicated that 75 percent of banks provide immediate or next-day availability with the option to apply holds on a case-by-case or exception basis. Applying case-by-case holds generally entails manual intervention to determine those checks on which holds should be imposed. Thus, the need for a method to apply automated holds appears to be limited to a minority (approximately 20 percent) of banks. Even though only a small number of banks place differential holds, these banks are often large and represent a greater proportion of all checks deposited.

By imposing differential holds for local and nonlocal checks, these banks have indicated a high level of concern about the risk of making funds available for withdrawal before learning whether a check has been returned. The Board recognizes that by not adopting the proposal requiring local routing numbers for payable through checks, a depositary bank electing to grant local availability for all checks drawn on the routing numbers of nonlocal payable through banks would increase this risk by granting local availability for checks that would not be subject to the local schedules under the regulation. In addition, banks applying differential holds are subject to litigation risk and could be liable for exceeding the maximum availability schedules if they do not grant local availability for a payable through check bearing a nonlocal routing number. Inaccurate assignment of availability could result when a teller makes errors in outsorting payable through checks or when the bank fails to accurately identify all nonlocal banks acting as payable

[6] A survey by Board staff identified 65 routing numbers that are used on bank payable through checks.

through banks for local banks. The Board believes that a depositary bank can control these risks through its diligent application of the process it chooses to use in applying holds to assure that it grants local availability for payable through checks issued by local banks.

Commenters in support of the proposal requiring local routing numbers also indicated that they would receive faster availability and incur lower collection costs for payable through checks drawn on local banks under this proposal than they can receive when sending the checks to the nonlocal payable through bank for collection. Suntrust Service Corporation, Orlando, Florida, stated, "Current volume from Suntrust Service Corporation Florida Operations to just the New York and Minneapolis share draft processors is approximately 6,500,000 items per year at a cost over $20,000.00 per year for transportation expenses."

Some bank commenters noted that this proposal would limit delayed disbursement. These commenters indicated that the credit unions using nonlocal payable through banks have an unfair float advantage over other banks. The Litchville State Bank, Litchville, North Dakota, commented, "For the credit unions to have special treatment is to give the banks and savings and loans unfair treatment. Please make the laws the same for all." The president of the Citizens Bank of Oviedo, Oviedo, Florida, commented, "* * * I think it should be illegal for any financial institution to carry its clearing account on the other side of the country so they can take advantage of float."

Payable through banks have indicated that many collecting banks receive availability for payable through checks drawn on a nonlocal payable through bank equivalent to that for checks collected locally by sending the checks directly to the nonlocal payable through bank. The payable through banks indicated that these "direct send" arrangements can only be cost effective for the collecting banks when sufficient volumes are being delivered to one presentment point and that maintenance of the payable through system is necessary to achieve these critical volume levels.

The majority of the banks commented that the potential risk of loss and increased exposure to fraud is also difficult to quantify. Bank of America stated, "The greatest potential savings, however, would not be operational. It would result from the reduced exposure to fraud losses * * *. While we have not attempted to estimate the fraud potential, as the processor of an estimated $850 million per year in payable through share drafts, our exposure is evident." Florida National Bank, Jacksonville, Florida, commented, "* * * this proposal would eliminate the likelihood that these checks would become vehicles for check fraud. It would reduce the collection time, reduce overall float, as well as reduce the risk for depository banks."

The 440 commenters that opposed the proposal, predominantly credit unions, indicated that requiring payable through checks to bear a local routing number in the MICR line was totally unacceptable and that its burden and high costs would far outweigh any benefits. Several commenters questioned the justification for the proposal. United States Senators Rudy Boschwitz and David Durenberger commented, "* * * the Federal Reserve has yet to demonstrate that a drastic step such as local MICR number is necessary in order to address perceived problems with the payable-through system. There are other solutions that should be explored before destroying a system that works well for credit unions." The Arizona Credit Union League, Inc., Phoenix, Arizona, stated, "* * * there is no evidence that the proposed changes are warranted. Indeed there are no cases of fraud or embezzlement on record that suggest problems with the payable through system to the degree suggested by the proposed regulations." CUNA commented that this proposal would "reduce efficiencies of the check collection system by creating thousands of additional endpoints."

Commenters expressed concern that this proposal could lead to the dismantlement of all national and regional payable through systems and thereby result in the loss of the efficiencies gained through economies of scale achieved from these systems. They explained that the payable through share draft program was initiated as a means for credit unions to provide a checking system to their members at a reasonable cost. Many credit unions stated that they are able to provide checking services only through the use of payable through processors, which provide efficient processing at a cost much lower than in-house processing. The Sherwin-Williams Employees Credit Union, Chicago, Illinois, stated, "Credit unions on a national or regional payable through program should not be forced to abandon their cost efficient, truncated system. This system has worked well for almost 15 years and has allowed thousands of credit unions to offer share drafts to millions of their members." The Alpena Alcona Area Credit Union, Alpena, Michigan, commented, "* * * the dismantlement of the payable through system would deprive members of a viable service, and at the same time increase the operational costs of the credit union—all without significant advantage." The Motorola Employees Credit Union, Schaumberg, Illinois, stressed that it chose Travelers Express as its payable through processor because the payable through program is both efficient and economical. It noted that it would be too costly to convert to in-house or local processing or to arrange for local intercept points.

Commenters expressed concern that local processors would not be able to provide the truncation services currently provided by the major payable through processors. They described the current truncation system as very cost efficient. H&E Telephone Federal Credit Union, Rochelle Park, New Jersey, noted that it previously used local banks to clear its checks but switched to a national processor that was superior. Problems with its local bank included: "(1) The return of actual checks to us which resulted in a mountain of paper and work to organize data; (2) poor reporting capabilities and longer time lags for information availability; and (3) more costly service charges."

Credit union commenters cited two costs of implementing the proposal requiring local routing numbers on payable through checks. First, credit unions and other banks issuing payable through checks would be required to either convert to in-house processing or establish a local presentment point for their payable through checks. They commented that these alternatives would be so costly that the continued share draft service would not be cost effective and would result in their imposing excessive fees on their members. Many commenters stated that an in-house system would not be economically feasible because of their small size and volume. The IBEW Federal Credit Union, Knoxville, Tennessee, commented that conforming "to the proposed amendments would be cost prohibitive due to increased processing costs, risk involved, and additional staff and data processing needs."

The City of Huntington Federal Credit Union, Huntington, West Virginia, indicated that a local bank estimated that it would charge approximately $30,000 per year to process the credit union's share drafts, compared to an annual charge of approximately $10,300 assessed by Chase Manhattan Bank to perform similar services. Another credit union estimated that current share draft account fees charged to credit union

members would triple if the credit union closed and they were forced to use local banks. A third credit union with 850 share draft accounts indicated that its per account cost would increase an estimated $41.41 annually as a result of this proposal. A credit union that uses the Travelers Express payable through draft processing service stated that its average per item cost is $.06 and the time required to receive and post accounts is less than one hour per day. This credit union estimated that this proposed amendment would require the purchase of additional equipment costing approximately $20,000 and the addition of one staff person at approximately $15,000 per year.

Commenters also noted that a second type of cost associated with the proposal is the cost of reissuing checks to customers. In addition to the cost of reissuing check stock, a change in routing number requires the additional cost of dual processing during the transition period when the processor must process checks with both the old and new routing numbers. The cost associated with dual processing will vary based on the time required to replace check stock. The Board believes that banks can minimize this time through diligent instruction to its customers in reordering and using new checks. These costs would either be borne directly by the customer, who would have to pay for new check stock, or indirectly by the customer through increased service charges imposed by the bank that bore the cost of replacing the check stock.

In addition to the cost/benefit analysis, the Board considered the competitive implications of this proposal. This analysis included competitive factors vis-a-vis credit unions vs. commercial banks. Credit union commenters indicated that because this proposal has the effect of limiting a credit union's choice of payable through bank, its adoption could prompt local banks to raise their fees. In addition, many credit unions believe that local banks may not have the incentive to keep costs down for the credit union issuing payable through checks because many of these local banks are competing for the same customer accounts as those held by the credit union. The Redford Township Community Credit Union, Redford, Michigan, stated, "This proposal would eliminate most of the competition which is a healthy situation for cost control."

Some credit unions indicated that they had no local processing options. The Fort Harrison VAF Federal Credit Union, Fort Harrison, Montana, stated, "* * * there is no Montana-based processing point at this time and one could not be set up within the one year deadline." The Jackson USDA Federal Credit Union, Jackson, Mississippi, commented that "there are no banks in the state of Mississippi that we know of that will process share drafts for credit unions." The manager of the Jackson USDA FCU contacted two local banks about processing share drafts and was informed that their market studies indicated there would be insufficient credit union share draft volume to make the share draft processing profitable.

Other comments indicated that the competitive issues between commercial banks and credit unions are broader than the issues raised by these payable through check proposals. Bank commenters indicated that the credit unions' tax-free status and liberal common bond restrictions give the credit unions an unfair advantage in competing for customers, which is only exacerbated by the credit unions' ability to issue payable through checks.

Commenters also noted that this proposal would have an anti-competitive effect on consumers by limiting choice of bank. The majority of small credit unions that commented on this proposal indicated that they would have to discontinue their share draft programs if the proposal were adopted because they would be unable to finance the increased human and equipment resource requirements. They expressed concern that they would no longer be able to offer a low cost checking alternative to lower income customers. The Pennsylvania Mennonite Federal Credit Union, Scottdale, Pennsylvania, stated, "In this day when the U.S. Congress is considering 'lifeline banking' and providing basic financial services that ordinary people can afford, we find it incongruous for a major organization such as the Federal Reserve System to mandate regulations which will either increase the cost of these services to our members or result in their discontinuance altogether."

The Newark Aerospace Federal Credit Union, Heath, Ohio, commented, "A lifeline no service charge share draft account might no longer be available to many of our members because of increased cost. If we could not afford the necessary equipment, 2,200 members would lose their share draft accounts and be forced to open checking accounts at banks. Recent reports indicate the average checking account costs the consumer close to $200 annually." Congressmen Frank Annunzio and Bruce Vento stated, "We believe the Board has consistently failed to balance the adverse effects such a proposed amendment will have on the medium to small credit unions and their life-line services, such as share drafts. Instead the Board cited unsubstantiated allegations of fraud and operation difficulties as its basis for requiring such a proposed amendment to Regulation CC."

Credit unions and payable through processors noted that this proposal would have an anti-competitive impact by limiting processing choice. The Dearborn Federal Credit Union, Dearborn, Michigan, stated, "Dearborn Federal believes that every credit union should have the right to choose the most efficient and cost effective system available." The Chase Manhattan Corporation stated, "If this approach were implemented, the Federal Reserve System with its extensive processing facilities and resources in every check processing region would have a competitive advantage over private sector providers in offering a national truncation service."

The Board believes that provision of truncation services by the Federal Reserve Banks and other private sector providers should help facilitate the payable through system by expediting the delivery of check information to the payable through bank, thereby allowing the payable through bank to provide more efficient, cost-effective payment services to credit unions. The Federal Reserve encourages private sector participation in providing truncation services, and the Reserve Banks developed their truncation service in coordination with private sector truncation service providers through the National Association for Check Safekeeping, which has expressed an interest in supporting the payable through system by means of truncation.

A few commenters noted that this proposal could be difficult to enforce because some credit union members order their own drafts from printing companies and they would be individually responsible for ensuring that their drafts have the proper routing number in the MICR line. A small number of commenters identified as another potential problem that some members would be reluctant to throw away unused drafts even if new drafts were issued free of charge.

The National Association for Check Safekeeping (NACS) proposed an alternative to this proposal. NACS proposed use of the 8000 series of routing numbers to identify checks that are payable through a bank nor located in the same check processing region as the issuer of the check. NACS noted that

the only current use of the 8000 series is for travellers checks.

Under the NACS proposal, the first digit of the routing number would be the number 8, identifying the 8000 series. The second and third digits would identify the check processing region of the bank on which the check is drawn. These two digits could be the number 01 through 48, identifying one of the 48 Federal Reserve check processing regions. The fourth and fifth digits would identify the check processing region of the payable through bank. Again, the two digits could be 01 through 48 identifying a check processing region. The sixth, seventh, and eighth digits would identify the particular payable through bank(s) within each check processing region. The ninth digit would be the check digit.

NACS stated, "Depositary banks could easily examine the 8000 series number and determine two things. Banks can determine where to send the check for collection and the funds availability to assign. Only banks using payable through processors in another check processing region will be eligible for an 8000 series routing number." Use of the 8000 series of routing numbers would enable banks to use automated equipment to read the MICR line to assign funds availability. Several commenters urged the Board to first research the NACS proposal further if the Board planned to adopt the proposal to require that payable through checks bear a local routing number in the MICR line. If the NACS proposal was determined to be an effective alternative, the commenters urged the Board to issue the proposal for public comment to determine whether it could provide the same benefits to depositary banks as the local routing number proposal without disrupting the national payable through system.

Board staff discussed the NACS proposal with industry representatives, equipment vendors, and check processing staff at the Federal Reserve Banks. Equipment vendors indicated that use of the 8000 series would require equipment upgrades at collecting banks, and that purchase and installment could take up to two years. Federal Reserve Bank staff indicated that this proposal could impact sort patterns, memory capacity for look-up tables, and processing schedules.

Adoption of the NACS proposal would also require reissuance of all payable through checks. Because the Board is adopting the conspicuous labeling requirement at this time, later adoption of the NACS proposal would require banks issuing payable through checks to reissue their checks twice. Two reissuances would be costly and burdensome for these banks and their customers.

Adoption of the NACS proposal would only benefit the approximately 20 percent of banks with blanket hold policies. The proposal would not provide incremental benefits to the large majority of banks that generally offer same-day or next-day availability. The NACS proposal would, however, impact all collecting banks because they would have to upgrade equipment to process these checks. Since this proposal would only benefit the minority of banks with blanket hold policies and would be burdensome for credit unions and collecting banks, the Board believes there is not sufficient justification to issue the NACS proposal for public comment.

Sovran Financial Corporation also suggested an alternative to the proposal requiring payable through checks to bear a local routing number in the MICR line. Sovran recommended that the "Board consider setting a specific time limit—two years—by which all issuers of payable through items wishing to obtain better acceptability for their items in the local marketplace must convert to using a local paying agent for the items, and to ensure that the items bear the routing number of the local paying agent. Those institutions which believe the costs of increased acceptability outweigh the benefits will still have the opportunity to use a distantly located payable through bank, but collecting banks will also have the opportunity to grant nonlocal funds access to depositing customers for these items." The Act does not give the Board the authority to lengthen the availability schedules, which would be the result of this proposed alternative.

Travelers Express Company, Minneapolis, Minnesota, recommended two alternatives to the proposal requiring a local routing number in the MICR line. Travelers suggested using position 44 in the MICR line to identify whether payable through checks are local or nonlocal. The Board believes that, while it would be possible to use position 44 to identify whether or not a check is a payable through check, manual intervention would still be necessary to determine whether such check is local or nonlocal. Thus, this alternative would provide only marginal benefit to depositary banks and should not be pursued at this time.

A second suggestion by Travelers Express was to implement "a requirement that payable through banks notify their local Federal Reserve of every routing number that includes items that would be considered local. The Fed could then publish a directory of these numbers. This would permit automation for the vast majority of the items at issue." As previously indicated, Board staff developed a list of 65 routing numbers that are used on bank payable through checks. The Board believes that, because banks may begin to offer or discontinue payable through services at any time, maintaining the accuracy of such a list and disseminating updated information to all depositary banks would be difficult.

Some commenters discussed the appropriate lead time for implementation of the proposed requirement that bank payable through checks bear a local routing number in the MICR line. The majority of the commenters noted that the proposed one year implementation time period was too short. Oak Ridge Government Federal Credit Union, Oak Ridge, Tennessee, commented, "My only suggestion would be that the implementation date be extended from 12 to 24 months. Any credit union that has gone through the conversion process already will tell you that it is impossible to accomplish in 12 months, and that is *after* the decision is made. The decision whether to go with a local third party processor or in-house can take 3 to 6 months."

The Board did not find reason to believe that the benefits of implementing the proposal to require payable through checks to bear a local routing number in the MICR line outweigh the reported costs of implementation, and thus is not adopting this proposal.

Authorize direct presentment to the bank on which payable through checks are written. Currently, the law is unclear as to whether a bank payable through check can be presented directly to the bank on which it is written or whether such checks must be presented to the payable through bank. Expressly permitting such checks to be presented directly to the bank on which they are written would enable banks to have such checks collected and returned locally, and thus would avoid delays in collection and return that might occur when the depositary bank sends the checks to nonlocal payable through banks.

The Board specifically requested comment on the cost and operational burden of this proposal on banks that use payable through checks, the potential cost savings to depositary banks, and the appropriate lead time for implementation of this proposal if adopted. Six hundred thirty-seven comment letters addressed this proposal. One hundred seventy-two

commenters supported the proposal and 465 commenters opposed it.

The commenters in support of this proposal commented that direct presentment would minimize the potential for fraud. National City Corporation, Cleveland, Ohio, commented, "To the extent that the proposal is employed, it would allow banks to determine the collectibility of checks/drafts in less time than otherwise would be the case, thereby reducing the risk of loss." The majority of the commenters that supported the direct presentment proposal indicated that they preferred the adoption of both the proposal requiring a local routing number in the MICR line and the direct presentment proposal.

A number of commenters indicated that they would like to have the option of direct presentment but did not indicate if they would actually present directly to the bank on which the checks are written, rather than to the payable through bank, if this proposal were adopted. The Chicago Clearinghouse Association stated, "The Association supports direct presentment of payable through items to the paying institution as an optional method of collecting such items * * *. In many cases, the option of direct presentment would be effective for speeding the forward collection process. However, we recognize that some collecting banks may not wish to exercise this option."

A small number of commenters suggested that the Federal Reserve should facilitate direct presentment. The United States League of Savings Institutions stated, "Having the Federal Reserve make direct presentments overcomes the cost prohibitiveness of having individual depositary banks making a presentment. Concentrating payable-through check volume at District Federal Reserve Banks makes this direct presentment alternative much more feasible." Continental Bank commented, "Our support for this option is also contingent on the Fed expanding its current fine-sort option to facilitate the direct presentment of payable through checks to the 'paying bank'. If this Fed expansion is not achieved, there would be no economical way to get the payable through checks presented directly to the individual credit unions."

Bank commenters noted that direct presentment would be used primarily by banks that have both the resources to perform this function and the volume to justify the expense. The Key State Bank, Owosso, Michigan, commented, "Allowing banks to present the items directly to a local credit union is only practical if sufficient volume allows a separate 'break out' of these items and ample capacity in the bank's equipment is available for a separate sort of these items."

Commenters noted that direct presentment would be useful in the case of large-dollar checks. The Bank Administration Institute commented, "Direct presentment does make sense, however, in the case of large dollar items. It is not uncommon for banks to single out large dollar checks for special handling. By presenting these items directly, a bank can often reduce float by accelerating the collection of funds. It also allows banks to determine the collectibility of items more quickly, reducing the risk of loss."

A small number of commenters noted that adoption of this proposal would simply clarify current law that provides that bank payable through checks can be presented directly to the credit union. The American Bankers Association stated, "Currently, old case law and Article 3 of the Uniform Commercial Code (UCC) might suggest that a 'drawee bank' (payor bank) may properly refuse to pay a check made payable through a particular bank when the check is not presented to the drawee by that bank. However, we believe that section 4-204(2) of the UCC * * * already authorizes collecting banks to send items directly to the payor bank. The Board should resolve this ambiguity by stating that banks may present directly to the bank on which the check is written."

The credit union commenters that opposed this proposal indicated that they did not have the operational capabilities to handle direct presentment. The Salt River Project Federal Credit Union, Phoenix, Arizona, commented, "Permitting depositary institutions to present a payable through share draft directly to credit unions for payment will create additional operational problems, especially for small credit unions. Many do not have the personnel nor the cash on hand to respond to direct presentment. They also do not own the equipment to handle direct presentment, and would be reduced to the equivalent of clearing all share drafts by hand! This was the reason the payable through system was set up in the first place, to allow credit unions to offer a transaction account, without the costly capital investment in personnel and equipment. The proposed changes would destroy their ability to offer transaction accounts by destroying the system that allowed them to offer those accounts in the first place."

The Credit Union National Association commented that this proposal would "dismantle the credit union payable through system, thereby eliminating share draft accounts for members of 1,500 to 2,000 small credit unions. Many small credit unions that could afford a local processing option would be put out of the share draft business because they simply cannot handle direct presentments. (Many of them are not capable of handling their own on-us items without depositing them in another financial institution.)"

A number of credit union commenters discussed the cost implications of direct presentment. The Billings Health Affiliated Federal Credit Union, Billings, Montana, stated, "I have 3 full time employee's (sic), including myself, who handle 2,500 members. We could not begin to do the direct presentments. Expenses involved would be a new safe which would run about $8,000 to $10,000.00. A new staff person at $12,000.00 per year and any expenses incurred through purchase of new electronic equipment. My net income YTD for 1988 is $20,699.04. I am sure you can see that to make the required staff increases and equipment purchases would just not be feasible. We would most definitely have to drop our program."

A few credit union commenters discussed the transportation costs of this proposal. The Missouri Credit Union League, St. Louis, Missouri, commented, "If this proposal is adopted, credit unions receiving a direct presentment from a depositary bank would have to arrange for timely delivery of these items to the payable through processor. Besides being a logistical problem it also creates an economic burden. At a minimum, checks would need to be sent by overnight courier service since timely delivery is a key issue. This would result in a minimum daily cost per credit union of approximately $14. The daily cost to Missouri credit unions would be $1,400 under this method. For large cash letters, credit unions would need to consider 'next flight out' arrangements. The daily cost for this type of courier service would be $1,000."

The majority of the credit union commenters stressed the same reasons for opposing the direct presentment proposal as they used in explaining their opposition to the proposal requiring a local routing number in the MICR line. These commenters cited the cost, lack of operational capability, and the potential dismantlement of the national payable through program if this proposal were adopted. These reasons are more fully articulated in the discussion of the proposal requiring bank payable through checks to bear a local routing number in the MICR line.

Bank commenters opposed to this proposal commented that this proposal does not facilitate the assignment of availability on an automated basis. The Maryland National Bank commented, "Although we conceptually support (the direct presentment proposal) * * * we could not support this option in terms of an actual implementation for the following reason: Again, this option would not permit the automated processing of the credit union drafts. We believe that any option which may require special nonautomated check handling will only weaken the check collection system." The Bank of Boston, Boston, Massachusetts, stated, "The Bank believes that this proposal is unworkable since it does not relieve depository institutions from the onerous task of manual identification of bank payable-through drafts."

Bank commenters also noted that direct presentment was only feasible for large organizations because the majority of banks would not receive enough share draft volume from one credit union in one day to make direct presentment worthwhile. The Alamo Savings Association of Texas commented, "This is not a practical alternative because of the transportation and settlement systems that would have to be developed to accommodate such direct presentment."

A small number of bank commenters discussed the cost implications of the direct presentment proposal. Provident National Bank, Philadelphia, Pennsylvania, commented, "It is also not a feasible alternative because of the large number of credit unions and the costs associated with direct presentment (transportation, cash letter processing and transaction costs). In addition to these costs are the costs associated with the manual outsorting of items and the manual intervention in those systems used to assign availability to customer deposits."

The Sovran Financial Corporation stated, "* * * to operationally effect direct presentment, we must manually sort through checks (in the case of one major payable through bank, some 30,000 items per day) to separate out those drawn on local institutions. To preserve some semblance of an audit trail, the items drawn on the distant payable through processor, would have to be rerun on our high speed check sorting equipment, and another cash letter created. The smaller groups of items drawn on individual local issuing institutions would similarly have to be rerun. Depending on the internal cost structures of individual banks, the incremental per-item cost to rerun these items could range from $0.005 to $0.012 cents per item pass. We estimate, given current annual volumes of payable through drafts cleared through one major national payable through processor, that reprocessing these items would cost us approximately $70,000 per year—excluding any forward presentment fees that we might also incur. Reconcilement and adjustment costs due to errors following from such a manually intensive endeavor would rise as well." Bank of America estimated that the cost of sorting the checks manually for direct presentment would be $800,000 per year.

Very few commenters commented on the appropriate lead time for implementation of this proposal. Suggested time frames ranged from immediately upon adoption of the amendment to three to four years after adoption.

The Board believes that there is not sufficient justification to clarify by regulation that a bank payable through check can be presented directly to the bank on which it is written. Therefore, the Board has not adopted this proposal.

Miscellaneous Recommendations. A number of commenters suggested alternatives other than the proposals issued by the Board. A small number of commenters noted that they disagreed with the Board's decision not to appeal the court ruling and urged the Board to appeal the ruling. First Pennsylvania Bank, Philadelphia, Pennsylvania, stated, "* * * we urge the Board to reconsider their previous position on this matter and to appeal the Federal court ruling concerning the treatment of payable through checks."

Some commenters recommended that the Board should seek amendments to the Act. The United BN Credit Union, St. Paul, Minnesota, stated, "Save the taxpayers money by sending your proposals for comment to all Congressmen and suggest they amend the law. They could amend the law to say checks drawn on local banks are local checks and checks drawn on nonlocal banks are nonlocal checks, PERIOD." The Board supports an amendment to the Act that would amend the definition of "originating depository institution" to mean the branch of a depository institution on which a check is drawn or through which a check is payable. If this amendment were enacted, the payable through bank would be defined as the paying bank in the regulation for the purpose of determining whether a payable through check is a local or nonlocal check.

A number of commenters requested the Board to require that bank payable through checks be deposited with a special deposit slip in order to receive local availability. Marine Midland Bank commented, "If the proposal to MICR encode a routing number which is local to the paying bank is not adopted by the Board, Marine would request the Board to consider permitting banks to require that bank payable through checks be deposited in person with a special deposit slip to a bank employee in order to get availability according to the schedule for local paying banks, if the paying bank is not in the same check processing region as the payable through bank." This would require an amendment to the Act because, under the Act, the Board does not have the authority to lengthen the availability schedules by requiring the use of special deposit slips as a condition for providing local availability to certain payable through checks.

A small number of commenters recommended that the Board should document the fraud, if any, caused by payable through checks and, if necessary, suspend the regulation for payable through checks. The Missouri Credit Union League commented, "Since the Fed has the authority to suspend the Regulation for certain classes of items, this appears to be more than adequate protection for the participants in the check collection system. Rather than be proactive without cause, a more prudent approach is to be reactive with cause."

The Independent Bankers Association of America recommended "that the Board adopt an amendment to Regulation CC requiring credit unions with payable through share draft programs to respond on a timely basis, to all inquiries from depositary banks on items over $500." A similar proposal was issued for public comment in December 1987, which would require banks issuing cashier's or teller's checks or certifying checks to respond to such inquiries. Several commenters on that proposal indicated that the provision would not protect depositary banks completely because many forgeries and counterfeits would go undetected. They also noted that depositary banks would not know where to direct the inquiry within the paying bank to obtain reliable information, or may not be able to contact or receive a response from the paying bank within a reasonable time. Therefore, the Board does not believe this proposal should be issued for public comment.

A number of credit union commenters requested that the Board delay consideration of these proposals to

allow sufficient time to evaluate the effects of Regulation CC on the check collection system. CBI Oak Brook Federal Credit Union commented, "* * * give the new system a year to function and gather some facts and figures on nonlocal payable-through-bank returns. There might be better ways to solve this liability problem in the future (if it exists) than the proposals that have been made." A number of depositary banks have expressed concern about their ability to comply with the revised regulation, and the Board believes it is appropriate to adopt amendments at this time.

Final Regulatory Flexibility Analysis

The Regulatory Flexibility Act (5 U.S.C. 601–612) requires an agency to publish a final regulatory flexibility analysis when it promulgates a final rule. Two of the requirements (5 U.S.C. 603(a) (1) and (2)) of a final regulatory flexibility analysis, (1) a succinct statement of the need for, and the objectives of, the rule and (2) a summary of the issues raised by the public comments in response to the initial regulatory flexibility analysis, a summary of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments are contained in the supplementary material above.

A third requirement of a final regulatory flexibility analysis (5 U.S.C. 604(a)(3)) is a description of each of the significant alternatives to the rule consistent with the stated objectives of applicable statutes and designed to minimize any significant economic impact of the rule on small entities which was considered by the agency, and a statement of the reasons why each one of such alternatives was rejected. As described in the above preamble, the Board included in its initial proposal several alternative rules, and requested and received comment on the cost and risk associated with each alternative for all affected entities, both large and small.

After considering the comments and the costs and benefits of the various alternatives on the affected entities, the Board adopted a final rule which it believes will have the minimum impact on small entities, generally credit unions, while still achieving the objectives of the rule. The reasons for the Board's final determinations are more fully described above. The Board did not, however, either propose or adopt an exemption from coverage for small institutions that use payable through checks. The purpose of the rules published today is to alleviate the operational difficulties and risk associated with the acceptance of payable through checks by depositary banks. This purpose would be defeated if the rules did not apply to small institutions that use payable through checks because the operational and risk problems for their checks would remain.

List of Subjects in 12 CFR Part 229

Banks, banking; Federal Reserve System.

For the reasons set out in the preamble, 12 CFR Part 229 is amended as follows:

PART 229—AVAILABILITY OF FUNDS AND COLLECTION OF CHECKS

1. The authority citation for Part 229 continues to read as follows:

Authority: Title VI of Pub. L. 100–86, 101 Stat. 552, 635, 12 U.S.C. 4001 et seq.

2. In § 229.36, the heading is revised and a new paragraph (e) is added to read as follows:

§ 229.36 Presentment and issuance of checks.

* * * * *

(e) *Issuance of payable through checks.* A bank that arranges for checks payable by it to be payable through another bank shall require that the following information be printed conspicuously on the face of each check:

(1) The name, location, and first four digits of the nine-digit routing number of the bank by which the check is payable; and

(2) The words "payable through" followed by the name and location of the payable through bank.

This provision shall be effective February 1, 1991, and after that date banks that use payable through arrangements must require their customers to use checks that meet the requirements of this provision.

3. In § 229.38, paragraph (d) is redesignated as paragraph (d)(1), a new heading is added to paragraph (d), and a new paragraph (d)(2) is added to read as follows:

§ 229.38 Liability.

* * * * *

(d) *Responsibility for certain aspects of checks*—(1) * * *

(2) *Responsibility for payable through checks.* In the case of a check that is payable by a bank and payable through a paying bank located in a different check processing region than the bank by which the check is payable, the bank by which the check is payable is responsible for damages under paragraph (a) of this section, to the extent that the check is not returned to the depositary bank through the payable through bank as quickly as the check would have been required to be returned under § 229.30(a) had the bank by which the check is payable—

(i) Received the check as paying bank on the day the payable through bank received the check; and

(ii) Returned the check as paying bank in accordance with § 229.30(a)(1).

Responsibility under this paragraph shall be treated as negligence of the bank by which the check is payable for purposes of paragraph (c) of this section.

* * * * *

4. Appendix E—Commentary to Part 229 is amended to read as follows:

a. Section 229.36 is amended by revising the heading and adding a new paragraph (e).

Appendix E—Commentary

* * * * *

Section 229.36 Presentment and issuance of checks

* * * * *

(e) Issuance of payable through checks. If a bank arranges for checks payable by it to be payable through another bank, it must require its customers to use checks that contain conspicuously on their face the name, location, and first four digits of the nine-digit routing number of the bank by which the check is payable and the legend "payable through" followed by the name and location of the payable through bank. The first four digits of the nine-digit routing number and the location of the bank by which the check is payable must be associated with the same check processing region. (This section does not affect § 229.36(b).) The required information is deemed conspicuous if it is printed in a type size not smaller than six-point type and if it is contained in the title plate, which is located in the lower left quadrant of the check. The required information may be conspicuous if it is located elsewhere on the check.

If a payable through check does not meet the requirements of this paragraph, the bank by which the check is payable may be liable to the depositary bank or others as provided in § 229.38. For example, a bank by which a payable through check is payable could be liable to a depositary bank that suffers a loss, such as lost interest or liability under Subpart B, that would not have occurred had the check met the requirements of this paragraph. The bank by which the check is payable may be liable for additional damages if it fails to act in good faith.

b. Section 229.38 is amended by redesignating the first three paragraphs of paragraph (d) as paragraph (d)(1); by adding a new heading to paragraph (d); by adding a new paragraph (d)(2) to follow newly redesignated paragraph (d)(1); and by revising the last paragraph of paragraph (d) to read as follows:

Section 229.33 Liability

* * * * *

(d) Responsibility for certain aspects of checks.—(1) * * *

(2) *Responsibility for payable through checks.* This paragraph provides that the bank by which a payable through check is payable is liable for damages under paragraph (a) of this section to the extent that the check is not returned through the payable through bank as quickly as would have been necessary to meet the requirements of § 229.30(a)(1) (the 2-day/4-day test) had the bank by which it is payable received the check as paying bank on the day the payable through bank received it. The location of the bank by which a check is payable for purposes of the 2-day/4-day test may be determined from the location or the first four digits of the routing number of the bank by which the check is payable. This information should be stated on the check. (See § 229.36(e) and accompanying Commentary.) Responsibility under paragraph (d)(2) does not include responsibility for the time required for the forward collection of a check to the payable through bank.

Generally, liability under paragraph (d)(2) will be limited in amount. Under § 229.33(a), a paying bank that returns the amount of $2,500 or more is not returned through the payable through bank as quickly as would have been required had the check been received by the bank by which it is payable, the depositary bank should not suffer damages unless it has not received timely notice of nonpayment. Thus, ordinarily the bank by which a payable through check is payable would be liable under paragraph (a) only for checks in amounts up to $2,500, and the paying bank would be responsible for notice of nonpayment for checks in the amount of $2,500 or more.

Responsibility under paragraphs (d)(1) and (d)(2) is treated as negligence for comparative negligence purposes, and the contribution to damages under paragraphs (d)(1) and (d)(2) is treated in the same way as the degree of negligence under paragraph (c) of this section.

By order of the Board of Governors of the Federal Reserve System, July 28, 1989.

Jennifer J. Johnson,

Associate Secretary of the Board.

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