



FEDERAL RESERVE BANK  
OF DALLAS

WILLIAM H. WALLACE  
FIRST VICE PRESIDENT

August 12, 1985

DALLAS, TEXAS 75222

Circular 85-109

**TO:** The Chief Executive Officer of all  
depository institutions in the  
Eleventh Federal Reserve District

**SUBJECT**

**Information brochures on Regulation J - amendment to improve the  
system of notification for nonpayment of checks \$2,500 or more**

**DETAILS**

As announced in Circular 85-30 dated March 8, 1985, effective October 1, 1985, Regulation J will be amended to strengthen the current requirement that payor depository institutions provide notice when they are returning unpaid large dollar checks presented through the Federal Reserve.

The attached brochures were prepared by the Federal Reserve's Check Product Management Office. They are information brochures designed to explain the Regulation J amendment to all financial institutions. The Federal Reserve Bank of Dallas and its Branch Offices will continue the practice of sorting to the institution of first deposit under the terms and conditions of the Return Item Pilot for the duration of the pilot. Pricing of return items will remain the same with no additional charge. However, the new notice of nonpayment service will require some operational modifications in the notice service now provided under the pilot. Outlined below are the operational changes we intend to incorporate into the pilot service.

Under the pilot, the Reserve Bank does not require a paying institution to separately sort the large dollar return items on which it wants the Reserve Bank to provide notification of nonpayment. Under the guidelines of the new service, this District will initiate payor large dollar notifications only upon receipt of the return check in a special envelope on a special return item letter. The special envelopes and return item letters will be furnished prior to October 1, 1985. The language in Appendix D of Bulletin 8 stating the terms and conditions of the pilot will be changed to require the paying institutions to make a separate sort of large items and a deadline of 12:00 noon will be set in order for this District to meet the System notification deadlines.

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For additional copies of any circular please contact the Public Affairs Department at (214) 651-6289. Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank (800) 442-7140 (intrastate) and (800) 527-9200 (interstate).

Notifications by telephone, on line, or initiated from the special return item letters for items handled for collection by the Federal Reserve will be handled at no extra charge for the duration of the pilot. For return items not handled for collection by the Federal Reserve, the Reserve Bank will make the necessary operational changes to receive telephone or wire notifications on such items from Eleventh District paying institutions. The Bank will pass those notifications on to the institution of first deposit, and charge the System's proposed \$2.25 and \$4.25 fees for the service. Payor institutions will be responsible for the timeliness of notifications.

Eleventh District on-line financial institutions will have the capability to send and/or receive large dollar return item notifications utilizing the Response Network. Additional information will be forwarded to you in the near future on this capability.

#### **ATTACHMENTS**

Attached are the Federal Reserve information brochures on return item notification.

#### **MORE INFORMATION**

For further information on the amendment, please contact the following individuals: Robert L. Whitman, (214) 698-4357 at the Head Office; Robert W. Schultz, (915) 544-4370 at the El Paso Branch; Vernon L. Bartee, (713) 659-4433 at the Houston Branch; or John A. Bullock, (512) 224-2141 at the San Antonio Branch.

Sincerely yours,

*William H. Wallace*

**Return Item**

**Notification**

*Information About* — *the New Requirement* —



# ***Return Item Notification: Information About the New Requirement***

This information was prepared by the Federal Reserve's Check Product Management Office. For further information or to obtain a copy of the specific amendment to the regulation (Regulation J) or the relevant Reserve Bank operating circular, contact your local Reserve Bank.

August 1985

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## General Overview

As a first step in ongoing efforts to resolve the problems associated with returned checks, the Federal Reserve Board recently amended one of its regulations (Regulation J) to improve the notification requirements currently in effect for financial institutions handling large-dollar return items. **The amendment, which affects all financial institutions receiving checks collected through the Federal Reserve System, establishes new notification procedures for returned checks of \$2,500 or more.** The amendment is **effective October 1, 1985.**

The objectives of the amendment to Regulation J are three-fold: first, to speed up the notice process on large-dollar return items; second, to make the actual notification more effective; and third, to establish liability regarding notifications in order to promote compliance. These improvements in the timeliness and usefulness of the notice of nonpayment should reduce the financial risk to the institution of first deposit. It is hoped that they also will help depository institutions to reduce the holds sometimes placed on deposited funds.

Specifically, the amendment to Regulation J:

1. requires that the institution on which the check is drawn (the payor institution) notify the institution where the check was first deposited (the institution of first deposit), that a large-dollar check (\$2,500 or more) is being returned;
2. establishes time limits for providing notification;
3. specifies the information to be included in the notification;
4. defines the responsibilities of the payor institution and of the institution of first deposit regarding the receipt of notifications;



5. establishes the liability an institution incurs if it fails to meet the notification requirements.

In contrast, prior to October 1, 1985, notification is to be made to the prior endorsing institution rather than the institution of first deposit. Moreover, prior to October 1, there are no specifications regarding the time limits for providing notification, the information to be included in the notification or the liability incurred for failing to provide notification. The Regulation J amendment creates new responsibilities for institutions both as payors and as collectors.

The following material discusses the specific requirements under the Regulation J amendment and procedures for fulfilling these requirements.

## ***Items That Require Notification***

Notification is required on a returned check if it meets the following four criteria:

1. the check was collected through the Federal Reserve System;
2. the check is for \$2,500 or more;
3. the check is not endorsed by, or for credit to, the United States Treasury;
4. the check itself will not reach the institution of first deposit within the time limit for notification.

Not all checks collected through the Federal Reserve System bear an endorsement from the Fed. For example, if a check has been processed as a fine sort item there will be no Federal Reserve endorsement on the check. If the item has been collected through the Federal Reserve System, the payor institu-

tion is required to provide notification to the institution of first deposit whether or not the item bears an endorsement from the Fed.

Notification should be made on a return item meeting the above criteria regardless of the reason for return.

## ***Party To Be Notified***

The institution on which the check is drawn (the payor institution) must notify the institution where the check was first deposited (the institution of first deposit) that a large-dollar check is being returned.

If the institution of first deposit is not located in any of the following areas:

1. the fifty states of the United States;
2. the District of Columbia;
3. Puerto Rico;
4. a territory, possession or dependency of the United States;

notification should be made to the first institution located in one of the above areas that handled the check.

## ***Time Limits for Providing Notification***

The amendment to Regulation J requires that if a payor institution has decided to return a large-dollar check, the payor insti-

tution must notify the institution of first deposit by midnight of the second banking day following the familiar "midnight deadline" for the return of the check. If the day on which notification is required is not a business day for the institution of first deposit, notification may be made on the institution of first deposit's next business day. For notification purposes the following are not considered business days:

- Saturdays and Sundays
- January 1 (New Year's Day)
- the third Monday in January (Martin Luther King Day)
- the third Monday in February (Washington's Birthday)
- the last Monday in May (Memorial Day)
- July 4 (Independence Day)
- the first Monday in September (Labor Day)
- the second Monday in October (Columbus Day)
- November 11 (Veterans Day)
- the fourth Thursday in November (Thanksgiving)
- December 25 (Christmas).

This amendment does not alter in any way the established deadline for the return of the item itself.

The following example illustrates the time limit established for providing notification:

If the Federal Reserve presents a check to a payor institution before 2:00 p.m. on Monday, that institution is required to *initiate* the return of the check, if dishonored, by midnight Tuesday. In addition, if the item is \$2,500 or larger, the payor institution must take steps to ensure that notification of return is *received* by the institution of first deposit by midnight Thursday (48 hours later). The payor institution should recognize that most depository institu-



tions cannot receive telephone or telegraphic notice after 5:00 p.m. local time (of the institution of first deposit). If the institution of first deposit is closed on the day of notification (Thursday in this example), notification should be made on the next business day of the institution of first deposit.

Exhibit 1 displays a time line corresponding to the above example. A time line indicating the impact of a weekend on the notification process is also included.

## ***Ways of Providing Notification***

Payor institutions may provide notification directly or indirectly to the institution of first deposit. If a payor institution wants to provide notification directly, the following two options are available:

1. ***The payor institution can return the unpaid check to the institution of first deposit within the notification time limit*** so that the returned check serves as the notification. For example, this alternative may be feasible when the institution of first deposit is nearby and the return item will pass quickly through the endorsement chain, or when the return can be made directly to the institution of first deposit. The Uniform Commercial Code and many state laws allow direct return to the institution of first deposit, bypassing the endorsement chain. However, before choosing to return directly, payor institutions should familiarize themselves with the state laws and procedures governing direct return to the specific institution of first deposit. Paying institutions should also understand the risk they assume since a delay in returning a check would result in failure to fulfill the notification requirement.

# Exhibit 1

## TIME LIMITS FOR NOTIFICATION

1

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
CHECK PRESENTED TO PAYOR INSTITUTION 11 A.M.	PAYOR MUST INITIATE THE RETURN BY MIDNIGHT		NOTICE OF RETURN MUST REACH THE INSTITUTION OF FIRST DEPOSIT	

2

WEDNESDAY	THURSDAY	FRIDAY	SATURDAY	SUNDAY	MONDAY
CHECK PRESENTED TO PAYOR INSTITUTION 11 A.M.	PAYOR MUST INITIATE THE RETURN BY MIDNIGHT				NOTICE OF RETURN MUST REACH THE INSTITUTION OF FIRST DEPOSIT

2. ***The payor institution can provide notification directly to the institution of first deposit*** using the telephone or another telecommunications network that would pass the message to the institution of first deposit. If a payor institution chooses to provide notification using an on-line Fedwire message, a fee of \$2.25 per advice will be charged. Fedwire can be used to notify on all checks, including those collected outside the Federal Reserve.

For a payor institution that is not on-line with a telecommunications network or does not want to provide notification directly, the following two services are available from its Reserve Bank:

1. ***The payor institution can provide the required information to the Reserve Bank by telephone, and instruct the Reserve Bank to notify the institution of first deposit.*** This option is available for all checks, including those collected outside the Federal Reserve. If a payor institution utilizes this option, a fee of \$4.25 per advice will be charged.
2. ***The payor institution can return the unpaid check to the Reserve Bank and instruct the Reserve Bank to extract the required information and notify the institution of first deposit.*** This option is only available for checks collected through the Federal Reserve. The Reserve Bank fee for this service will be \$4.25 per advice.

If the Reserve Bank assists a payor institution in providing notification, the Reserve Bank is subject to the liabilities discussed in the section titled *Liability*. Specific instructions and deadlines, for those payor institutions planning to use the Reserve Bank notification services described above, are available from your local Reserve Bank.

Other institutions, such as correspondent banks, service bu-



reus and wire services, may provide notification services similar to those described in this section. Payor institutions interested in obtaining services from a particular institution other than the Reserve Bank should contact that institution directly to find out what services are available.

## ***Initiating Notifications — Guidelines for Payor Institutions***

Payor institutions should maintain appropriate records indicating their compliance with the notification requirements. For example, payor institutions are encouraged to record telephone notifications, keep copies of incoming and outgoing wires and maintain wire logs.

A notification is considered received under the following conditions:

1. ***Return of the unpaid item***—If the payor institution is returning the unpaid item within the time limit for notification, the item is considered received if it is delivered by arrangement to a messenger from the institution of first deposit, or if it is delivered to any of the following addresses associated with the institution of first deposit:
  - a. the address specified by the institution of first deposit as the address to receive notifications—this address could be at the institution or at an alternate processor;
  - b. the address normally used for return items;
  - c. the address of the branch named on the endorsement;
  - d. the main address of the head office (in many in-



stances, this is not the preferred option of the institution of first deposit).

2. **Telephone notice**—If a payor institution is using a telephone call to provide notification, notification is considered received if both of the following two conditions are met:
  - a. a phone call is made to any of the following areas associated with the institution of first deposit:
    - the number specified by the institution of first deposit—this number could be at the institution or at an alternate processor;
    - the number of the return item unit;
    - the general number of the branch named in the endorsement;
    - the general number of the head office (in many instances, this is not the preferred option of the institution of first deposit).
  - b. the telephone is answered and the notification is accepted by the institution of first deposit.

The amendment allows an extension of the notification period if any of the following problems occur during telephone notification:

- a. the telephone is not answered;
- b. the telephone is answered but the person who answers it refuses to accept the notification or to transfer the call;
- c. the telephone is answered but the person doesn't appear to understand the nature of the call.

In the above circumstances, the notification period is

extended to the morning of the next business day of the institution of first deposit. However, unless the payor institution has reason to believe that the institution of first deposit will receive telephone notice after 5:00 p.m. local time (of the institution of first deposit), the payor institution should call prior to that time.

3. **Telegraphic or wire notice**—If a payor institution is using Fedwire or any other telegraphic form to provide notification, notification is considered received if it is delivered to any of the following areas associated with the institution of first deposit:
  - a. the address specified by the institution of first deposit as the address to receive notification—this address could be at the institution or at an alternate processor;
  - b. the return item unit;
  - c. the main telegraphic or wire address (in many instances, this is not the preferred option of the institution of first deposit).

If a payor institution knows that the telegraphic notification has not been received by the institution of first deposit, the payor institution is required to send a follow-up notice confirming the notification. The confirming notice should be delivered no later than the morning of the next business day of the institution of first deposit. Again, payor institutions are expected to recognize that most institutions cannot receive wire or telegraphic notifications after 5:00 p.m. local time (of the institution of first deposit).

The institutions of first deposit also have specific responsibilities regarding the receipt of notifications. Institutions are expected to establish the internal procedures necessary to accept notifications and to make sure that notifications are directed to the appropriate person or area and acted on accordingly. For

example, institutions of first deposit may not instruct telephone operators to refuse to accept notifications but may establish procedures to have the operator transfer a call, record the call or have an appropriate person return the call. Similarly, institutions of first deposit that are receiving notifications over an electronic link are expected to manage the link so that notifications can be accepted during daytime hours.

The institutions of first deposit are also encouraged to simplify the notification process by complying with the endorsement standard of the American National Standards Institute and by using only current routing numbers.

## ***Information To Be Included in the Notification***

The following information must be included in the notification, to the extent that the information can be obtained from the check:

1. name and routing number of the payor institution (the institution that the check is drawn on);
2. name of the payee (the person or company to whom the check is made payable);
3. amount of the item;
4. date of the endorsement of the institution of first deposit;
5. account number of the depositor;
6. name of the branch at which the check was first deposited (this information is particularly important for those large financial institutions that may use the same account numbers at more than one branch);



7. trace number (item sequence number) of the institution of first deposit;
8. reason for return.

In the event that there is some question about a given piece of information, paying institutions are encouraged to include the questionable information and follow it with question marks.

Notification does not have to be provided if the payor institution cannot determine the institution of first deposit at all (i.e., both the name and the routing number of the institution of first deposit are illegible). However, if the routing number of the institution of first deposit is illegible or missing but the name is legible and is sufficient to identify the institution of first deposit (or vice versa), notice is required, even if the payor institution has to look up the routing number or the name and address of the institution.

If the payor institution is uncertain as to which of two or more institutions is the institution of first deposit (because their endorsements have the same or illegible dates), the payor institution is authorized but not required to provide notification to each institution and note its uncertainty as to which is the institution of first deposit. Each notified institution is then responsible for determining if it is the institution of first deposit.

In the event that a payor institution provides the above information to an institution of first deposit and then decides to pay the check, the payor institution must send a second notice, as soon as is reasonably possible, cancelling its previous notification of nonpayment. The second notice should indicate that it is a second notice cancelling a previous notice and should contain all the information included in the original notice so that the institution of first deposit can match the second notice with the earlier notice.

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## ***Voluntary Information To Be Included***

The Federal Reserve encourages payor institutions to provide some additional information in the notification, even though this information is not required by Regulation J. This information is:

1. name(s) and account number of the drawer (the person who wrote the check);
2. check number;
3. date of the item;
4. any other information that might be helpful, such as
  - a. the name of the last endorser, other than a depository institution, if different from the payee;
  - b. an obsolete routing number of the institution of first deposit if used on the item.

Exhibits 2 and 3 illustrate the information (required and voluntary) to be included in the notification.

## ***Liability***

The amendment to Regulation J establishes the following liability regarding the new notification requirements:

1. A payor institution that fails to exercise ordinary care in meeting the notification requirements will be liable for losses incurred by the institution of first deposit up to the amount of the item.

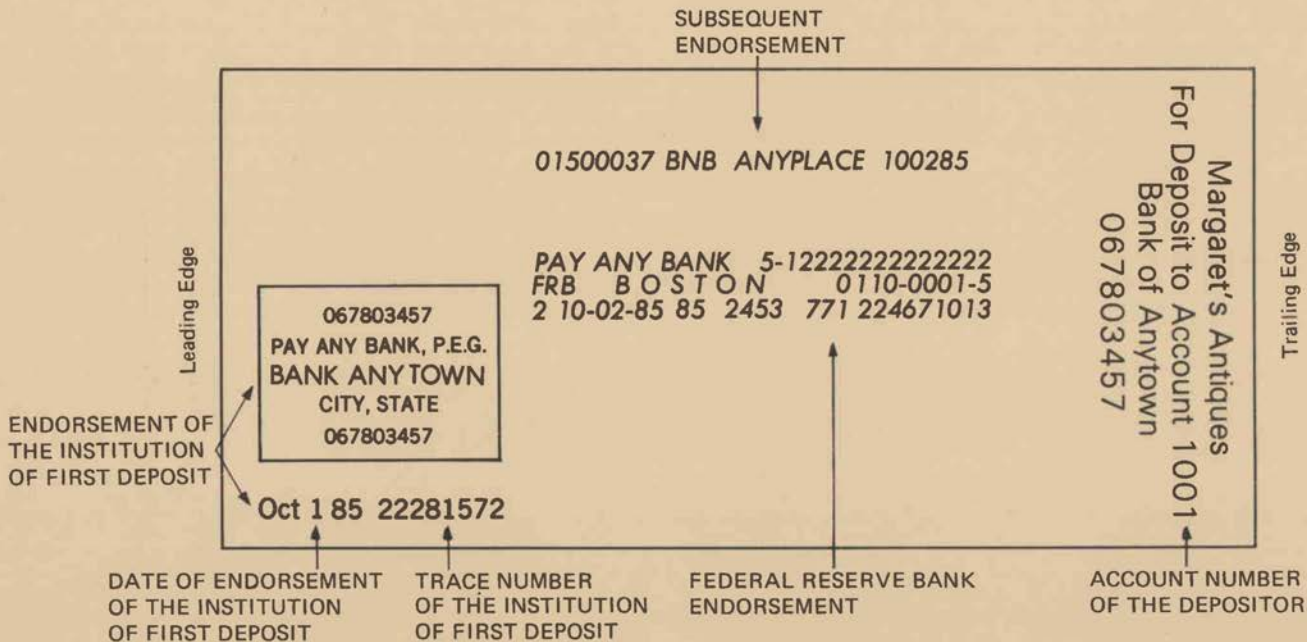
## Exhibit 2

### NOTIFICATION INFORMATION OBTAINED FROM THE FRONT OF THE CHECK

	NAME OF THE DRAWER	NAME OF THE PAYEE	DATE OF THE ITEM	CHECK NUMBER	
	KATHARINE ADAMS			No. 346	
	ADDRESS CITY, STATE		October 1 1985	56-7890 1234	
Trailing Edge	PAY TO THE ORDER OF <i>Margaret's Antiques</i>			\$2959 <sup>00</sup>	Leading Edge
	<i>Twenty-nine hundred fifty-nine dollars and <sup>00</sup>/<sub>100</sub> DOLLARS</i>				
	<b>NAME OF PAYING INSTITUTION</b> CITY, STATE		<i>Katharine Adams</i>		
NAME OF PAYING INSTITUTION	ROUTING NUMBER OF PAYING INSTITUTION		346	'0000295900'	AMOUNT OF THE ITEM

Exhibit 3

NOTIFICATION INFORMATION OBTAINED FROM THE BACK OF THE CHECK





2. A payor institution that fails to act in good faith in meeting the requirements may also be liable for other consequential damages suffered by the institution of first deposit.
3. The prevailing institution in any lawsuit involving a notification may recover its court costs and reasonable attorneys' fees.

In cases where the Reserve Bank assists the payor institution in providing notification, the Reserve Bank is subject to the liabilities discussed above.

Regulation J allows the payor institution an extension in complying with the notification requirements if the delay in complying is due to an interruption of communication facilities, emergency conditions or other circumstances beyond the institution's control, provided that the institution exercises diligence in attempting alternative means of notice.

Both the payor institution and the institution of first deposit have new responsibilities regarding the dispatch and receipt of the various forms of notification. If a question of liability arises over a failure to provide notification in a specific instance, a decision regarding liability will have to be made by the courts.

As a separate issue, a payor institution also continues to incur a potential liability if it fails to meet the midnight deadline specified in the Uniform Commercial Code for timely return of the item itself.

## ***Responsibilities of the Institution of First Deposit***

The amendment to Regulation J creates new responsibilities for the institution of first deposit. These responsibilities involve two areas: notification receipt and endorsement standards.

1. **Notification receipt**—As detailed in the section titled *Initiating Notifications—Guidelines for Payor Institutions*, payor institutions can provide notification to any one of several areas associated with the institution of first deposit. Therefore, a major responsibility of the institution of first deposit is to establish appropriate internal procedures to accept notifications and to assure that when notifications are received at any of the areas specified, the notifications are directed to the person or area responsible for acting on the information. For example, the institution of first deposit may not instruct telephone operators to refuse to accept notifications but may establish procedures to transfer calls regarding notifications, to record the calls or to have an appropriate person return the calls. Similarly, institutions of first deposit that are receiving notifications over an electronic link are expected to manage the link so that notifications can be accepted during daytime hours.

Once the notification has been received in a timely manner by the institution of first deposit, at one of the specified locations, the institution of first deposit becomes liable for any losses associated with an unpaid item.

2. **Endorsement standards**—Payor institutions are not required to provide notification on large-dollar return items if they cannot decipher the endorsement of the institution of first deposit. To simplify the notification process, the institution of first deposit is encouraged to comply with the endorsement standards of the American National Standards Institute<sup>1</sup> and to use only cur-

<sup>1</sup> *Specifications for Check Endorsement*, catalogue number x9.3 1981, details the standards established for endorsement content, color and placement. This publication can be ordered from the American National Standards Institute (ANSI), 1430 Broadway, New York, N.Y. 10018 at a cost of \$5.00 per copy. If you need further information about the publication please call the Institute at (212) 354-3473.

rent routing numbers. Institutions are encouraged to use the full nine digit routing number, not the fractional form, and to include the appropriate telephone number for return notification in the endorsement where feasible.

Although it is not required, it is also recommended that large depositors be given a stamp with the name and routing number (and appropriate telephone number for return notification if possible) of the institution of first deposit.

## ***Further Information***

If you have any questions regarding the new amendment, or require further information or assistance, please contact your local Reserve Bank.

