



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

July 1, 1988

DALLAS, TEXAS 75222

Circular 88-43

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

SUBJECT

**Request for public comment on a proposed amendment to Regulation CC --
Availability of Funds and Collection of Checks**

DETAILS

The Federal Reserve Board has issued a request for public comment on a proposed amendment to Regulation CC -- Availability of Funds and Collection of Checks to restrict certain delayed disbursement practices.

Delayed disbursement is the practice of delaying payment of a check by drawing the check on a bank located in an area that is remote from the payee in order to increase the time it takes to clear the check. These practices reduce the efficiency of the check collection system and increase the risks to depository banks, which must meet the availability schedules of the Expedited Funds Availability Act and Regulation CC.

The proposed rule, which would be effective April 1, 1989, would permit a bank to issue an official check drawn on another bank only if a depository bank located in the same community as the issuing bank can receive credit for the check as early as a check drawn on the issuing bank. Comment is also sought on several additional questions related to delayed disbursement practices.

Your comments should be submitted by September 23, 1988, to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, D.C. 20551.

ATTACHMENTS

The Board's notice is attached to provide additional background material.

MORE INFORMATION

For additional information, please contact Dean Pankonien at (214) 651-6662

Sincerely yours,

FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Regulation CC; Docket No. R-0639]

Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is publishing for comment a proposed rule amending its Regulation CC, Availability of Funds and Collection of Checks (12 CFR Part 229). The proposed rule addresses problems connected with delayed disbursement practices by setting out requirements for the issuance of teller's checks.

DATES: Comments must be submitted on or before September 23, 1988.

ADDRESSES: Comments, which should refer to Docket No. R-0639, may be mailed to the Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551,

Attention: Mr. William W. Wiles, Secretary; or may be delivered to Room B-2223 between 8:45 a.m. and 5:00 p.m. All comments received at the above address will be included in the public file and may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT: Elliott C. McEntee, Associate Director (202/452-3926), Louise L. Roseman, Assistant Director (202/452-3874), Brada Panther, Analyst (202/452-2831), Division of Federal Reserve Bank Operations, or Stephanie Martin,

Attorney, Legal Division (202/452-3198); for the hearing impaired only: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

Delayed disbursement is the practice of delaying payment of a check by drawing the check on a bank¹ located in an area that is remote from the payee. Delayed disbursement practices are designed to increase the time it takes to clear a check. These practices reduce the efficiency of the check collection system and increase the risks to depository banks, which must meet the availability schedules of the Expedited Funds Availability Act ("Act") (12 U.S.C. 4001-4010) and Regulation CC. Delayed disbursement increases the time for the collection and return of a check as well as the costs to process and transport the check, due to the increased likelihood that the check must be processed through multiple intermediary banks. This delay may also result in a check being returned after funds must be made available for withdrawal under the Act.

The Federal Reserve System has been concerned with the problem of delayed disbursement for a number of years. The

¹"Bank" is defined in Regulation CC to include all depository institutions. A "paying bank" is the bank that pays the check and includes payable through and payable at banks. A "depository bank" is the bank in which the check is first deposited.

Board issued a policy statement on January 11, 1979, that discouraged abuse of the check collection system through remote disbursement. The policy statement enumerated the Board's principal concerns with respect to remote disbursement, including the risk of loss to depository banks and recipients of remotely disbursed payments, denial to consumers and small businesses of access to funds due them (a problem which has been addressed, in part, by the Act and Regulation CC), and the possibility of unsafe or unsound banking practices caused by unsecured extensions of credit to customers whose funds at the remote paying bank are not sufficient to cover the customer's checks. The Board stated that it believes the banking industry has a public responsibility not to design, offer, promote, or otherwise encourage the use of a service expressly intended to delay final settlement and that exposes payment recipients to greater than ordinary risks.

On February 23, 1984, the Board issued another policy statement that further discouraged the use of arrangements that result in a delay in the collection and final settlement of checks. In addition to reiterating the concerns expressed in the 1979 policy statement, the Board stated that delayed disbursement results in higher transportation and processing costs and an increased possibility of check fraud. The Board also stated that it intended to monitor the success of voluntary efforts to reduce and eliminate the use of delayed disbursement arrangements and, if abuses continued, to pursue appropriate action. In conjunction with this policy statement, the Board

implemented the High-Dollar Group Sort Program to reduce the level of float and accelerate the collection of checks.

The Expedited Funds Availability Act evidences Congress' intent to speed the availability of funds to bank depositors and, therefore, suggests that a reevaluation of delayed disbursement practices is appropriate. Although many classes of checks are subject to delayed disbursement, the ramifications of delayed disbursement are particularly significant in the case of teller's checks.

Regulation CC requires a depository bank to make the proceeds of certain checks deposited in transaction accounts, including cashier's checks, teller's checks,² and checks drawn on Federal Reserve Banks and Federal Home Loan Banks, (collectively "official checks") available for withdrawal on the business day following deposit, under specified conditions. If these checks are drawn on a remote paying bank, the depository bank may not receive credit for the check by the time funds must be made available to the customer for withdrawal. Thus, the practice of delayed disbursement permits a depository institution issuing such checks to impose costs, in terms of lost interest, on other depository institutions and to retain for itself interest earned on outstanding checks until the checks are presented for payment.

A recent Federal Reserve Bank survey of official checks

²Regulation CC defines "teller's check" as a check provided to a customer of a bank or acquired from a bank for remittance purposes, that is drawn by the bank, and drawn on another bank or payable through or at a bank.

indicates that approximately 60 to 80 percent of official checks are deposited in a bank that is located in the same state as the issuing bank. Some banks issue official checks that are drawn on a paying bank remotely located from the issuing bank. In these cases, the paying bank is often remotely located from the depository bank.

Prior to enactment of the Act, the Board's ability to address delayed disbursement abuses was limited to discouraging such practices through policy statements, and through Federal Reserve Bank services, such as the High-Dollar Group Sort Program, which accelerates the collection of certain delayed disbursement checks. The Expedited Funds Availability Act authorizes the Board to make improvements to the check system to speed the collection and return of checks, and, thus, to restrict delayed disbursement practices. Specifically, the Act gives the Board "the responsibility to regulate any aspect of the payment system, including the receipt, payment, collection, or clearing of checks; and any related function of the payment system with respect to checks." (12 U.S.C. 4008(c)(1).)

In December 1987, the Board requested public comment on proposed Regulation CC as well as proposals for long-term improvements to the check collection system. A number of commenters on the proposed Regulation CC cited the inequity of requiring the depository bank to make the proceeds of official checks available for withdrawal on the business day after deposit, if the bank cannot receive credit for the check by that time. Some commenters requested that the Board restrict the

next-day availability requirement to checks for which the depository bank can receive credit within that time.

The Board specifically requested comment on how to address delayed disbursement practices and the practice of issuing official checks payable in a different check processing region than the issuing bank. The majority of commenters addressing this issue indicated that the practice of issuing official checks drawn on another institution located in a different check processing region should be eliminated. One commenter noted that delayed disbursement of official checks may have particular effects on deposits to escrow accounts used in residential real estate closings. Deposits to these accounts are comprised predominantly of official checks that must be accorded next-day availability, although the depository bank does not receive credit for a portion of these checks until a later date. The commenter noted that the later return of these checks poses risks to the escrow companies. Several other commenters (all providers of official check services) opposed any regulatory action to limit the location of the paying bank.

Despite the past policy statements of the Board, certain delayed disbursement practices continue to be employed. Many corporations and banks find delayed disbursement attractive, because the timing of the presentment of the checks they issue, and hence payment for these checks, is delayed, giving the drawer of the check use of the funds needed to pay the check for a longer period of time. Delayed disbursement is also very profitable to the banks that provide such services.

These delayed disbursement practices, however, often disadvantage the depository bank that sends the check for forward collection as well as the depositor of the check. The costs to the depository bank are particularly high in the case of remotely disbursed checks that must be given next-day availability under Regulation CC. Delayed disbursement may also pose additional risks to depository banks.

Certain banks, particularly savings and loan associations, credit unions, and small commercial banks, issue teller's checks as official checks rather than issuing cashier's checks (i.e., checks a bank draws on itself). Some teller's checks are subject to delayed disbursement, where the paying bank is remote from the issuing bank in order to extend the time within which the check is collected. In some cases these checks are drawn on a RCPC³ routing number, rather than a Reserve Bank city routing number, further delaying the collection of these items.

Many member savings and loan associations draw checks on their accounts at Federal Home Loan Banks that are provided to customers as the functional equivalent of teller's and

³"RCPC" checks are drawn on depository institutions located in areas designated within the territories of Federal Reserve offices but outside Federal Reserve cities. "City" checks are drawn on depository institutions located in the same city as the processing Federal Reserve office. When deposited for collection, RCPC checks generally must be deposited several hours earlier than city checks in order to receive comparable availability.

cashier's checks. In the case of Federal Home Loan Bank checks, checks may be issued by a member of one Federal Home Loan Bank and drawn on another Federal Home Loan Bank.

There are a number of reasons, other than delayed disbursement, that banks may wish to issue teller's checks as their official checks. Due to specialization and economies of scale, certain banks or other service providers can perform the issuing, tracking, reconciliation, and payment services associated with these payment instruments at a lower cost than can the issuing bank itself. These types of arrangements are beneficial as long as they do not rely on delayed disbursement to achieve the cost benefits.

Request for Comment

The proposed rule, which would be effective April 1, 1989, would amend § 229.36 of Regulation CC to provide that a bank that issues a teller's check must draw the check on or designate the check payable through or at a bank such that a depository bank in the same community as the issuing bank will be able to receive credit for the check as early as if the check were drawn on the issuing bank itself. For the purposes of Subpart C, a teller's check includes a check drawn on a Federal Reserve Bank or a Federal Home Loan Bank. The Board is also publishing for comment a Board interpretation of the proposed rule to be added to the official Commentary contained in Appendix E of Regulation CC. In addition, the Board requests comment on the following issues:

1. Does the proposed regulation unnecessarily disrupt current correspondent relationships? If so, in what way(s)?
2. Should the Board require that official checks be conspicuously identified by labeling them in a certain way and by prohibiting the label on other checks? If yes, what specific requirements should be imposed?
3. Should the Board require that the name of the paying bank be printed prominently and in a standardized location on the check?
4. Should the proposed regulation further define the community in which the issuing bank is located?
5. Should the proposed regulation's standard for equivalent availability be tied to specific Reserve Bank deposit deadlines that are applicable to checks to be presented in the paying bank's community?
6. Should the proposed regulation's standard for equivalent availability be expanded to cover checks other than official checks?
7. Should the Board require official checks not drawn on the issuing bank to be payable at multiple presentment points?
8. Are the liability standards of Regulation CC, Subpart C, appropriate for violations of the proposed requirement?

9. Should the proposed regulation's standard for equivalent availability rule provide an exception for official checks that do not meet the availability test, but that are likely to be deposited at locations distant from the issuing bank? For example, several commenters asked that the practice of issuing official checks drawn on a New York city correspondent, regardless of the location of the issuing bank, to remit funds to foreign payees not be restricted. Under what circumstances should an exception apply?
10. If banks in the issuing bank's community generally do not collect checks through the Federal Reserve, should the availability schedules of one or more correspondent banks used by banks in that community be used to determine whether the proposed regulation's standard for equivalent availability has been met?

Initial Regulatory Flexibility Analysis.

Of the items required to be contained in an initial regulatory flexibility analysis by 5 U.S.C. 603(b), the first ("a description of the reasons why action by the agency is being considered") and the second ("a succinct statement of the objectives of, and legal basis for, the proposed rule") are found elsewhere in this preamble.

The requirements of the proposed rule would apply to all banks subject to the rule regardless of size. The proposed rule would affect any bank that issues a teller's check that does not meet the equivalent availability standard of the rule;

the Board anticipates that a number of small banks will be affected by the rule. The Board considered exempting very small banks, those that fall below the threshold for filing reports of deposit under the Board's Regulation D (12 CFR Part 204) (currently those with deposits of less than \$2.9 million) from the rule's requirements. If such an exemption were allowed, however, small banks would continue to be able to engage in delayed disbursement of teller's checks, and depository banks, which must make the proceeds of such checks available for withdrawal according to the availability schedules of Regulation CC, would incur additional costs and risk due to this practice. The Board believes that the problems of delayed disbursement can be addressed only if the proposed rule applies to all banks.

Because the proposed rule would only affect an issuing bank's choice of the paying bank for its teller's checks, the Board does not anticipate that the rule will impose significant costs on small banks other than the costs of changing paying banks and purchasing new check stock for those banks that do not currently meet the equivalent availability standard. The Board does not anticipate that the proposed rule would impose extra reporting or recordkeeping burdens on small banks.

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 proposed to be amended as follows:

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. The heading of § 229.36 is revised and a new paragraph (e) is added to § 229.36 to read as follows:

§ 229.36 -- Presentment and issuance of checks.

* * * * *

(e) Issuance of teller's checks. A bank shall not issue a teller's check if a depository bank located in the same community as the issuing bank would not normally receive credit for the check as early as for a check drawn on the issuing bank.

3. In Appendix E, the heading for Section 229.36 is revised and a new paragraph (e) is added to Appendix E, Section 229.36 to read as follows:

Appendix E. -- Commentary

* * * * *

Section 229.36 Presentment and Issuance of Checks

* * * * *

(e) Issuance of teller's checks. This paragraph requires that a bank that issues a teller's check must draw the check on or designate the check payable through or at a bank such that a depository bank in the same community as the issuing bank will be able to receive credit for the check as early as if the check were drawn on the issuing bank itself. For the purposes of Subpart C, a teller's check includes a check drawn

on a Federal Reserve Bank or a Federal Home Loan Bank. Two banks are in the same community if they are in the same city, town, or similar locality. Under this rule, a bank in Atlanta could issue a teller's check drawn on a New York bank only if an Atlanta depository bank would receive credit for that check as promptly as it would for a check drawn on the issuing bank.

To determine whether a depository bank in the same community as the issuing bank would receive credit for the check as early as it would for a check drawn on the issuing bank, an issuing bank may look to the availability schedule and deposit deadlines of the Federal Reserve Bank office that serves the issuing bank. The applicable deposit deadlines are the deadlines banks in the issuing bank's community would normally use to deposit checks drawn on the paying bank. Thus, to determine whether a teller's check meets the proposed rule's equivalent availability test, the issuing bank must compare (1) the availability its local Federal Reserve office provides for checks drawn on the issuing bank and deposited at the deposit deadline generally used by banks in the issuing bank's community for collecting such checks, with (2) the availability that its local Federal Reserve office provides for checks drawn on the paying bank and deposited at the deposit deadline generally used by banks in the issuing bank's community for collecting such checks. For example, if a Federal Reserve Bank provides credit for checks drawn on a paying bank located in another Federal Reserve district that are deposited by the local Reserve Bank's Other Fed deadline at the same time as for checks drawn on the

issuing bank that are deposited at the local Reserve Bank's RCPC deadline (which is later than the Other Fed deadline), the equivalent availability test would not be met if banks in the issuing bank's community generally arrange their transportation to the local Reserve Bank such that the checks arrive for processing after the Other Fed deadline, but before the later RCPC deadline. In this example, depository banks would receive credit for checks drawn on the paying bank, located in another Federal Reserve district, one day later than they would for checks drawn on the issuing bank.

Most checks cleared outside the Federal Reserve System are collected at least as quickly as checks collected through the Federal Reserve System, and therefore the Federal Reserve Bank collection times serve as reasonable proxies for collection times generally. Availability under the Federal Reserve's High-Dollar Group Sort Program, however, may not be considered in determining equivalent availability because, in many cases, the collection times under this program are not matched by the private sector, and therefore such availability does not serve as an appropriate proxy for the normal collection time. Moreover, the depository bank must incur additional costs to collect checks under this program.

An issuing bank that issues a teller's check for which equivalent availability requirements are not met may be liable to the depository bank or others as provided in § 229.38. For example, an issuing bank could be liable to a depository bank that suffers a loss resulting from increased float or due to a

late return of a check if the loss would not have occurred had the check met the equivalent availability standard. The issuing bank may be liable for additional damages if it fails to act in good faith.

Board of Governors of the Federal Reserve System, June
21, 1988.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board