



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

DALLAS, TEXAS 75222

October 28, 1988

Circular 88-78

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

SUBJECT

**Final rule on handling of "payable through" checks under the
Expedited Funds Availability Act and request for comment**

DETAILS

The Federal Reserve Board has issued a final ruling under the Expedited Funds Availability Act stating that "payable through" checks must be treated as local or nonlocal checks based on the location of the institution on which they are written rather than the "payable through" bank. This action finalizes an interim amendment adopted by the Board in August in response to a court order.

In addition, the Board published for public comment four proposals designed to help ease the operational difficulties and lessen the risks imposed on financial institutions as a result of the court's order. The proposals would:

- * require bank payable through checks to bear a local routing number in the MICR line and to have a local presentment point;
- * require such checks to be conspicuously labeled as payable through checks and to contain specified information;
- * allow these checks to be presented directly to the bank on which they are written; and
- * reallocate the risk of loss where the checks are payable through a nonlocal bank.

A more detailed explanation of the ruling and the proposals for Regulation CC which implements the Expedited Funds Availability Act are attached. Any comments should be sent by December 30, 1988, to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551

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).

ATTACHMENTS

The Board's notices regarding this issue are attached.

MORE INFORMATION

For additional information, please contact Robert L. Whitman (214) 698-4357 or Dean A. Pankonien (214) 651-6662 at the Dallas Office, Robert W. Schultz (915) 544-4730 at the El Paso Branch, Luke E. Richards (713) 652-1544 at the Houston Branch, or John A. Bullock (512) 224-2141 at the San Antonio Branch.

Sincerely yours,

William H. Waller

FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Regulation CC; Docket No. R-0648]

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 proposed amendments to its Regulation CC, Availability of Funds and Collection of Checks (12 CFR Part 229). The proposed rule changes would alleviate the operational difficulties and additional risks associated with the acceptance for deposit of payable through checks.

DATES: Comments must be submitted on or before December 30, 1988.

ADDRESSES: Comments, which should refer to Docket No. R-0648, 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: Louise L. Roseman, Assistant Director (202/452-3874), Gayle Thompson, Program Leader (202/452-2934), Division of Federal Reserve Bank Operations;

Oliver Ireland, Associate General Counsel (202/452-3625),
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, with minor technical changes,
the interim rule issued on August 18, 1988, to amend
Regulation CC to treat "bank payable through checks" as local or
nonlocal based on the location of the bank¹ on which they are
written rather than the location of the bank through which they
are payable, as a final rule. (See Docket R-0643, published
elsewhere in today's Federal Register.) The Board is issuing,
for a 60-day public comment period, proposed amendments to
Regulation CC designed to alleviate the operational difficulties
and additional risks resulting from this final rule.

BACKGROUND

As adopted in May 1988, Regulation CC provided that
checks written on an account at one bank but payable through
another bank were to be considered local or nonlocal under
Regulation CC and the Expedited Funds Availability Act ("Act")

¹Regulation CC defines bank to include all depository
institutions, including commercial banks, savings and loan
associations, and credit unions. A depository bank is defined as
the first bank to which a check is transferred.

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 depository banks.² In addition, treating the payable through bank as the paying bank would facilitate the handling of these checks by depository banks because it would permit 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 where the payable through bank is located, and to assign availability for the check on the basis of that number.

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

²Under the regulation, depository banks may differentiate funds availability based on whether the check is written on a local or nonlocal paying bank. A local paying bank is one located in the same check processing region as the depository bank. As of September 1, 1988, depository banks must make the proceeds of local checks available for withdrawal not later than three business days following deposit; nonlocal checks must be made available for withdrawal not later than seven business days following deposit. On September 1, 1990, these schedules are reduced to two and five business days for local and nonlocal checks, respectively.

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, and 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, bank payable through checks should be treated as local or nonlocal on the basis of the location of the credit union 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.

The Board received 155 comments on the interim rule. (A summary of the comments appears below.) The overwhelming majority of the commenters (144) objected to the treatment of bank payable through checks as local or nonlocal on the basis of the location of the bank on which they are written, because this rule creates operational difficulties and increased risks for depository banks. Many of the commenters suggested various means of addressing these operational problems and risks.

The Board has adopted the interim rule, with minor technical changes, and is also proposing for comment amendments to Regulation CC designed to alleviate the operational difficulties and increased risks resulting from the interim rule. These proposed amendments are based on specific suggestions of the commenters 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 is issuing these proposals for comment to gain further information concerning whether the proposals are 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 impose undue burdens on the banks on which bank payable through checks are written.

DISCUSSION

Although bank payable through checks represent only two to three percent of the approximately 47 billion checks written each year, they are sufficiently prevalent to create substantial operational problems for banks in complying with the Act, as interpreted by the court, and Regulation CC, as amended by the interim rule, and to increase the risk of check fraud for depository banks. Available data indicate that the two largest payable through processors handle approximately 700 million bank payable through checks each year. Although the majority of bank payable through checks are written on the more than 4,000 credit unions that use such checks, they are also used by some savings and loan associations and commercial banks. The Board has identified at least 65 banks across the country that serve as payable through banks and believes that others exist that have not yet been identified.

Ordinarily, many banks that provide different availability for local and nonlocal checks identify the checks as local or nonlocal based on the routing number in the Magnetic Ink Character Recognition ("MICR") line on the bottom of the checks. This routing number is either entered into the bank's computer system by the teller at the time the transaction is made (on-line processing) or read from the check using automated equipment during subsequent processing (batch processing). The first four digits of the nine-digit routing number are used to identify the Federal Reserve check processing region to which

the check is sent for payment and thus permit the bank to readily identify whether a check is local or nonlocal. In the case of a bank payable through check, however, the routing number cannot be used to determine whether the check is local or nonlocal because it identifies the payable through bank rather than the bank on which the check is written.

Accordingly, in order to determine whether a check is local or nonlocal, depository banks must first determine whether it is a payable through check. Generally, there are two ways to identify these checks. First, they can be identified by visual inspection by the teller at the time that the checks are received for deposit. This procedure is labor intensive, and therefore costly, and prone to the high level of errors associated with manual processing. Once a check is identified as a payable through check, it may still be difficult to determine whether the check is local or nonlocal because some bank payable through checks do not contain on the face of the check the location of the bank on which they are written. Even if this information is included on the face of the check, the local/nonlocal determination may be difficult to make due to the information's placement on the check or its type size. In addition, in cases where the location is clearly identifiable, it may be a difficult task to determine whether the bank on which the check is written is in the same check processing region as the depository bank, because most check processing regions contain only portions of states. The depository bank

may need to refer to a list of cities and towns in its check processing region to determine if the bank payable through check is local for purposes of Regulation CC.³

The second way to identify bank payable through checks is to program a check reader-sorter to outsort all checks bearing the routing number of the payable through banks and either to assign those checks local availability, even when they are not payable by a local bank, or to inspect them visually to determine whether they should be assigned local or nonlocal availability. Although many bank payable through checks bear routing numbers that are used almost exclusively for such checks, others bear routing numbers that are also used for significant numbers of non-payable through checks. In addition, some payable through banks serve banks in a number of Federal Reserve check processing regions. Treating all checks bearing the routing number of a payable through bank as local also results in giving local availability to an unknown number of checks that may be treated as nonlocal. In addition, it creates an incentive for banks to act as payable through banks so that their checks may be considered local by banks that use this approach to comply. Further, as noted above, it is difficult to identify all banks that serve as payable through banks. A bank

³Listings of cities and states in individual Federal Reserve check processing regions are available upon request from local Federal Reserve Bank offices.

may begin or cease acting as a payable through bank at any time. Any listing of payable through bank routing numbers is likely to omit certain payable through banks, thus causing banks relying on that list to violate the Act by giving nonlocal availability to checks that should receive local availability under the Act. Finally, commenters indicated that if a bank wishes to inspect bank payable through checks visually once they have been identified in order to determine whether they are local or nonlocal, that process will be costly and error-prone and may delay the collection of those checks.

In addition to the operating problems caused by bank payable through checks, these checks are attractive vehicles for check fraud. The time that it takes bank payable through checks to travel to and from the depository bank is a function of its location in relation to the payable through bank, not the bank on which the check is written.⁴ Consequently, it generally takes longer for checks that are sent to a nonlocal payable through bank to be collected and returned than it does for

⁴Chase Manhattan, one of the two major national payable through processors, stated in its comments: ". . . if the payor bank decides not to pay a draft, the time that it takes the draft to travel to the depository bank is a function of its location in relation to the payable through bank, not the payor bank. Therefore, when a payable through bank returns a draft received from a nonlocal depository bank, it must be afforded the benefit of the longer return time for nonlocal items notwithstanding that the payor bank may be in the same check processing region as the depository bank."

checks that are sent to a local bank. In the case of many depository banks, these collection and return times will regularly exceed the availability schedules in the Act for local checks. Persons wishing to commit check fraud on those depository banks would be able to rely on the fact that the bank must make the proceeds of the checks available for withdrawal before it had an opportunity to learn that the checks had been dishonored.

Under the Expedited Funds Availability Act, the Board has the authority to adopt regulations to address these problems. Although the language of the Act governing the availability of checks is sufficiently specific for the court to conclude that the Act requires local availability for bank payable through checks written on local banks but payable through nonlocal banks, the Act gives the Board general authority to regulate the check collection system. Section 609(c)(1) of the Act provides:

RESPONSIBILITY FOR PAYMENT SYSTEM--In order to carry out the provisions of this title, the Board of Governors of the Federal Reserve System shall have the responsibility to regulate--

(A) any aspect of the payment system, including the receipt, payment, collection, or clearing of checks; and

(B) any related function of the payment system with respect to checks.

This authority is extremely broad and, together with section 609(a) of the Act, which authorizes the Board to prescribe rules to facilitate compliance with the Act, gives the Board the

authority to adopt reasonable changes to the way that checks are handled, provided that those changes further the purposes of the Act, such as by expediting the collection and return of checks or facilitating compliance with the availability schedules.

The Board believes that there are a number of approaches to dealing with the operational and risk problems associated with bank payable through checks, including: (1) requiring such checks to be presentable locally and to bear a local routing number in the MICR line; (2) requiring such checks to be conspicuously labeled as payable through checks, specifying the name and location of the payable through bank and the name, location, and nine-digit routing number of the bank on which the check is written; (3) authorizing collecting banks to present such checks directly to the bank on which they are written; and (4) shifting to the bank on which the check is written the risks of loss due to the time required for the return of such checks from nonlocal payable through banks.

1. Require bank payable through checks to be presentable locally and bear a local routing number in the MICR line. Eighty-nine commenters expressed concern about the operational problems posed by the court ruling and interim amendments. A number of these commenters suggested that the Board require credit unions to encode their own routing numbers on their checks, or that of a local payable through bank. This would permit depository banks to determine whether any check is local or nonlocal through the use of automated equipment,

because the routing number encoded on the check would indicate the check processing region of the bank on which the check is written. Therefore, this approach would effectively remove the operational difficulties in assigning appropriate availability to these checks.

In addition, this proposal would address the concerns expressed by 111 commenters regarding the potential risk of additional losses and increased exposure to fraud for depository banks as a result of the revised rule defining the bank on which the payable through check is written as the paying bank for determining funds availability. The proposal would eliminate the likelihood that these checks would become attractive vehicles for check fraud because a bank payable through check with a local routing number could be presented to the local address associated with the routing number, maintaining a clear link between the time it takes to collect and return the check and the time within which the depository bank must make the funds available to the depositor.

This proposal would require the reissuance of payable through checks encoded with routing numbers not associated with the same check processing region as the bank on which the checks are written and may also require a bank to change its payable through check processor. The cost of reissuing checks and converting to a different processor depends, in part, on the lead time between the adoption of the proposal in final form and the effective date of this requirement. These costs would have

to be weighed against the costs to the banking industry in general of identifying bank payable through checks by other means and the risks arising from the use of nonlocal payable through banks for these checks.⁵

When some credit unions began offering share draft accounts to their members in the mid-1970s, they used payable through banks exclusively to process checks written on those accounts (predominantly two national payable through processors), in part due to competitive concerns with having local banks processing their checks. With the enactment of the Monetary Control Act of 1980, credit unions were able to obtain their own routing numbers, and thus had greater processing options. In addition, other service providers began offering share draft processing services to credit unions, including correspondent banks, corporate credit unions, state credit union leagues, credit union service organizations, regional data processors, and service bureaus.

According to CUNA, the current trend is for credit

⁵One industry consultant indicated that "on average, 80 to 85% of [credit union] members will reorder [share drafts] in a nine to twelve month period." (July 13, 1988, affidavit of David McCurrach, President of McCurrach & Company.) Dearborn Federal Credit Union, in a June 16, 1988 affidavit, noted that, if it were to convert to local processing, it must either incur the costs of reprinting share drafts for all of the credit union's members (estimated at \$7 per member), or incur the cost of operating a full-scale dual processing system for one year while some members are converting to new share drafts and others are using up their old payable-through share drafts.

unions to shift to local processors or in-house processing. CUNA reports that six percent of credit unions now process in-house, while 25 percent use local processors in an intercept arrangement, rather than a payable through arrangement. (In an intercept arrangement, the credit union uses its own routing number on its checks, rather than the routing number of the processor.) The remaining 69 percent of credit unions use a payable through bank for processing, a small portion of which use a local payable through bank.

The proposed requirement would not necessarily preclude nonlocal processing of payable through checks. Currently, arrangements exist whereby payable through checks are delivered to a local presentment point and subsequently transported to the nonlocal processing site. For example, some corporate credit unions serve market areas that encompass multiple check processing regions, and thereby provide services to members located in one or more nonlocal check processing regions. Such arrangements tend to be regional rather than national in scope due to transportation times necessary to move the payable through checks from the presentment point to the processing site. Thus, this proposal might cause a shift from national payable through processing to regional or in-house processing. On the other hand, national payable through processors could develop regional operations in order to continue to provide

services to banks that issue payable through checks.⁶

The Board considered, as an alternative to this proposal, a proposal to require payable through checks to be identified as such in the MICR line of the check. There is only one field in the MICR line (position 44) that such information can be contained. Because this field is also used to identify checks, including payable through checks, for other purposes (e.g., to identify the check as eligible for truncation), and because the industry is interested in reserving the use of this field for a number of other purposes, this alternative is not attractive. Moreover, this approach would only indicate to the depository bank whether the check is a payable through check; it would not provide sufficient information to determine, in an automated environment, whether a payable through check is local or nonlocal.

The Board is publishing for comment a proposed amendment to Regulation CC to require bank payable through checks to bear a routing number in the MICR line that is associated with the same check processing region as the location of the bank on which the check is written, and to require a

⁶Traveler's Express, one of the two major national payable through processors, has established three regional processing centers in the past four years, and has stated that it plans to establish additional regional processing sites in the future, in order to retain credit union customers that are seeking local processing.

presentment point for such checks in that check processing region. This requirement would be effective one year following adoption of the amendment. The Board specifically requests comment on the cost savings to depository banks and the costs to banks using such checks so that the benefits and costs of this proposal can be more fully assessed.

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. In order for banks to be able to separate 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, certain information pertaining to the payable through bank and the bank on which the check is written must be included on the check. Commenters indicated that information on the face of the check indicating the name and location of the credit union and the legend "payable through" followed by the name and location of the payable through bank is crucial to the visual identification of these checks, although it would not permit their identification by automated equipment. In addition, 10 commenters indicated that the assignment of availability to these checks would be facilitated by requiring the routing number of the bank on which they are written to be included on the face of the check. Furthermore, CUNA stated in

its submissions to the court that printing the name, address, and first four digits of the routing number of the bank by which the check is payable on the face of the check would be a reasonable way to help depository banks determine whether a payable through check is local or nonlocal.

Inclusion of the routing number on the face of the check would permit bank personnel to assign availability to these checks without the need to refer to a list of cities and towns in the depository bank's Federal Reserve check processing region to determine if the location of the bank on which the check is written is local for purposes of Regulation CC.⁷ The need for the routing number of the bank on which the check is written to be printed on the face of bank payable through checks would be eliminated if the Board adopts the requirement that all bank payable through checks bear a local routing number

⁷An 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 transfers to or from an account at the bank on which the check is written so that the ACH transfers would be sent to the bank on which the check is written rather than to the payable through bank, which generally rejects the transfer. The bank routing number and account number information that is necessary to establish an ACH transfer arrangement is often obtained from a voided check supplied by the bank customer. If this information is obtained from a bank payable through check, the routing number does not identify the bank to which the ACH transfer should be directed, resulting in problems for the payable through bank, the customer, the originator of the payment, and the bank to which the ACH transfer should be directed.

in the MICR line. The other required information would still be needed, even if the first proposal were adopted. 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.⁸ Furthermore, the name of the payable through bank and some indication that the check is payable through that bank appears to be required by current law.⁹ The requirement that specified information be printed on the face of the check would not address the potential risks of bank payable through checks becoming attractive vehicles for fraud. If this proposal were adopted, the bank on which the payable through checks are written may incur costs to reissue its checks, if the checks currently do not contain the required information. Unlike the first proposal, however, this proposal would not require any bank to move its payable through check processing to a different bank.

The Board is publishing for comment an amendment to Regulation CC that would require bank payable through checks to

⁸The Federal Reserve Operating Circular on the Collection of Cash Items and Returned Checks states that banks should not send to a Reserve Bank for forward collection a check that "does not state on its face the name and city and state address of the paying bank associated with the routing number on the item". (Paragraph 7(e).)

⁹See 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. 1248 (1978), and Phelan v. University National Bank, 85 Ill. App. 2d 56, 229 N.E.2d 372, 4 UCC Rep. Serv. 635 (1967).

conspicuously state the name and location of the payable through bank and the bank on which they are written, as well as the routing number of the bank on which they are written, and the legend "payable through" on the face of the check. If adopted, this requirement would be effective one year following adoption of the amendment. The Board specifically requests comment on the cost savings and operational benefits to depository banks and the costs to banks using such checks that would result from the adoption of this proposal.

3. Authorize direct presentment. 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. In its Share Draft Operating Manual published in 1983, ICU Services, a CUNA affiliate, states "the credit union management has the right to refuse to accept a payable through share draft which is presented directly to the credit union." On the other hand, the American Bankers Association ("ABA") commented that, while old case law and Article 3 of the Uniform Commercial Code ("U.C.C.") might suggest that a payor bank may properly refuse direct presentment of payable through checks, "it can be argued that present section 4-204(2) of the UCC (which overrides Article 3 of the UCC in the event of a conflict of provisions) already authorizes collecting banks to send items directly to the payor bank." The ABA also commented that even if some depository institutions assert that they are "nonbank payors" in

order to avoid direct presentment under U.C.C. § 4-204(2)(a), the Board has the power to promulgate regulations permitting direct presentment under U.C.C. § 4-204(2)(c) and section 609(c)(1) of the Expedited Funds Availability Act.

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 the delays in collection and return that occur when the depository bank sends the checks to nonlocal payable through banks. Although direct presentment of bank payable through checks would not alleviate the operational burdens of identifying these checks and assigning them the appropriate availability, it may reduce the likelihood that they would become attractive vehicles for check fraud because depositors could not rely on the longer collection and return times for nonlocal checks.

If this proposal is adopted, the Federal Reserve Banks may consider expanding their fine sort check collection service to facilitate direct presentment of payable through checks to the bank on which the checks are written. Under this service, collecting banks that want the Federal Reserve Bank to present payable through checks directly to the bank on which they are written, rather than to the payable through bank, would be required to fine sort these checks according to the routing number of the bank on which the checks are written.

The extent to which a rule expressly permitting direct presentment of these checks to the bank on which they are written would impose burdens on such banks is not clear. These banks generally already receive direct presentment of some checks over the counter for their customers. Further, the extent to which the volume of checks presented directly would increase is unknown. The presentment of a significant number of such checks may cause operational burdens for these banks because they are generally not equipped to process large volumes of checks. The need for this rule would be diminished if bank payable through checks were required to have a local routing number in the MICR line, and a corresponding local presentment point.

The Board is publishing for comment an amendment to Regulation CC that would authorize direct presentment of bank payable through checks. The Board specifically requests comment on the cost and operational burden of this proposal on banks that use payable through checks, the potential cost savings to depository banks, and the appropriate lead time for implementation of the proposal, if it is adopted.

4. Shift risk of loss to bank on which check is written. One hundred eleven commenters expressed concern regarding the potential risk of losses and increased exposure to fraud for depository banks as a result of the revised rule defining the bank on which the payable through check is written as the paying bank for determining funds availability.

Commenters argued 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 depository banks would not be increased by the revised rule. These commenters suggested that the revised definition of paying bank also be applied to the expeditious return rules in Subpart C of the regulation.

The effect of the revision suggested by the commenters can also be achieved by requiring that the bank on which a payable through check is written bear any losses incurred by the depository bank due to return of a check from a nonlocal payable through bank in a time longer than would have been required for return of the check if it had been presented directly to the bank on which it was written. This rule would not address the operational difficulties in identifying these checks and would not protect the depository bank from risks due to any longer time required to present such checks to a nonlocal payable through bank. On the other hand, the burden that this rule would place on banks on which such checks are written would be minimal and would be limited to losses for which they were responsible because of the location and return procedures of the payable through bank that they selected. The need for such a rule would be eliminated if bank payable through checks were required to have a local routing number in the MICR line and would be diminished if direct presentment of payable through checks were authorized.

The Board is publishing for comment an amendment to Regulation CC that would place the risk of loss for return of bank payable through checks from nonlocal payable through banks on the banks 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 Board requests comment as to whether this allocated liability should be computed solely under the two-day/four-day test in § 229.30(a)(1) of Regulation CC or whether it is possible to also compute such liability under the forward collection test in § 229.30(a)(2). The Board also requests comment on the appropriate lead time for implementation of this proposal if it is adopted.

SUMMARY OF PROPOSALS

These proposed amendments address many of the operational and risk concerns raised by the commenters in response to the revised rule adopted by the Board to treat bank payable through checks as local or nonlocal based on the location of the bank on which they are written rather than the location of the bank through which they are payable. The Board is publishing for public comment, the following proposed amendments to Regulation CC, to determine whether they would facilitate compliance with Regulation CC and 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 payable through checks are written.

1. Require bank payable through checks to be presentable locally and to bear a local routing number in the MICR line [See proposed regulatory language -- amendments to § 229.36(b), (f) (Alternative 1), and (g) (Alternative 1)];

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 [See proposed regulatory language -- amendment to § 229.36(g) (Alternative 2). Alternative 3 combines Alternatives 1 and 2];

3. Authorize direct presentment to the bank on which bank payable through checks are written [See proposed regulatory language -- amendments to § 229.36(b) and (f) (Alternative 2)]; and

4. Allocate losses for return of bank payable through checks from a nonlocal payable through bank to the bank on which such checks are written, to the extent the process of return took longer than would have been required if the check had been returned by the bank on which they are written [See proposed regulatory language -- amendment to § 229.38(d)(2)].

In addition, elsewhere in today's Federal Register, the Board is proposing for comment several other technical amendments to Regulation CC relating to payable through checks (see Docket R-0649).

SUMMARY OF COMMENTS

The Board received a total of 155 comments on the interim rule. The following table reflects these comments by category of respondent:

Commercial Banks and Bank Holding Companies*	129
Credit Unions	3
Savings and Loan Associations	12
Trade Associations	8
Individuals	3

* Identical comments submitted by three employees of the same bank are counted as one comment.

A total of 144 commenters opposed the definition of paying bank as interpreted by the court decision. Fifty-three percent of the commenters urged the Board to appeal the court ruling. Ten commenters suggested that the Board should request that Congress amend the law. Five commenters concurred with the revisions made in the interim rule. The majority of the commenters discussed the operational concerns and the increased risk of fraud loss caused by the court ruling. They indicated the need for longer term initiatives aimed at easing the operational burden of identifying payable through drafts and minimizing the risk of fraud losses for depository banks.

Operational Concerns. A total of 89 commenters expressed concern about the operational problems caused by the ruling. Banks will no longer be able to rely on the routing number to determine whether a bank payable through check is local or nonlocal. Commenters stated that they will have operational difficulties in assigning availability to payable through checks. They expressed concern that depository banks will have to revert to a complex manual process in order to

distinguish share drafts payable by local credit unions from other checks for the purpose of determining availability. Personnel will have to be trained to inspect each check visually to determine whether the check is local or nonlocal. Individual handling and visual inspection will create a larger probability of error and possibly cause delays in collection and return. Commenters were also concerned that tellers would have difficulty determining the availability of payable through checks based on the geographic location of the credit union, because most check processing regions contain only portions of certain states. Reference to a detailed listing of cities and towns in the depository bank's check processing region would often be required to determine accurately whether a credit union is local or nonlocal to the depository bank.

Commenters stated that determination of holds on a manual, rather than automated, basis would increase the expense of processing deposits and would decrease the efficiency of the processing, contrary to Congress' expressed intent in the Act that the Board take steps to improve the check system. Camden National Bank, Camden, Maine, commented, "we are no longer in the Stone Age of check processing where an individual examines each item and sorts it. We are a small bank; however we do our own check processing and handle an average of 25,000 checks for deposit nightly." The Huntington National Bank, Huntington, Ohio, stated, "we process 20 million items per month on the basis of the routing transit number; the time and expense of

sorting through these items by hand would be prohibitive." The commenters stated that the burden of identifying a local or nonlocal check has been placed on the depository bank without a standard industry identification procedure. The majority of the commenters believe that the routing number should continue to be the controlling determination for availability. They referred to the routing number method as efficient and proven.

Some commenters proposed initiatives to ease the operational burdens created by the interim rule. A few commenters requested that the Board develop an alternative method of identifying checks as local or nonlocal in an automated check processing environment. One commenter suggested that the credit union should be required to encode a character in the MICR line to identify the check as a payable through check.

Ten commenters suggested that the credit union should have its own routing number printed on the face of the check. Commenters also recommended that, at a minimum, the credit unions should identify their checks as payable through and include their own name and address and the name of the payable through bank on the face of the check.

A number of commenters suggested that a list should be developed of the credit unions that use nonlocal payable through banks. Another alternative suggested was a list of routing numbers for all payable through banks in each Federal Reserve district.

Fifteen commenters recommended that the Board should allow depository banks to require the use of a special deposit slip for payable through checks that are to be treated as local items. They noted that Regulation CC currently requires special deposit slips for certain next-day items and suggested that the same rules apply to payable through checks. The special deposit slips would make these items more easily identifiable for tellers.

Risk of fraud loss. One hundred eleven commenters expressed concern regarding the potential risk of losses and increased exposure to fraud for depository banks. They stated that the interim rule will expose depository banks that accept share drafts for deposit that are payable by a local credit union but payable through a nonlocal bank to additional risk because such share drafts would not have to be returned as expeditiously as local checks would normally be returned. The commenters indicated that most share drafts payable through a nonlocal bank would not be received by the depository bank before funds must be made available under the local availability schedule. Home Loan Savings Bank, Fort Wayne, Indiana, commented that "in the past, we have on many occasions, experienced inordinate delays of from 12 to 18 days in the return of local credit union share drafts payable through distant nonlocal banks."

Commenters argued that checks considered local for the purposes of determining availability should also be considered local for determining whether the checks are returned expeditiously. They recommended that the revised definition of paying bank be applied to the rules of Subpart C, in particular the expeditious return rules, as well as the availability rules of Subpart B. They noted that this would also reestablish the clear connection between the availability requirements and the time required for a check to be cleared and returned.

Commenters also suggested that the credit union on which the check is written should be responsible for any losses incurred.

American Bankers Association, Washington, D.C., stated:

To relieve the unfair risk imposed on banks in this situation, we strongly recommend that the Board extend the revised definition of paying bank to Subpart C relating to the collection of checks. The expeditious return standard should be determined by the location of the payor bank since that location determines whether a local or nonlocal check funds availability schedule applies.

Thirty-five commenters stated that the interim rule promotes delayed disbursement. They noted that the revised definition of paying bank is inconsistent with the Federal Reserve Board's proposal to restrict remote disbursement of teller's checks and the Board's overall efforts to discourage delayed disbursement.

Eight commenters recommended that the final rule authorize direct presentment to credit unions that use payable through checks. They indicated that, under direct presentment, depository banks would have the option of collecting payable

through checks locally in those cases where local availability must be provided, and thus would generally learn if a check has not been paid prior to the time funds must be made available for withdrawal.

Twenty-five commenters favored requiring a credit union to use a local payable through bank. They noted that this requirement would reduce the risks to the depository bank by maintaining the clear link between the time it takes to collect and return a check and the time within which the depository bank must make the funds available to the depositor. They stated that if the credit unions want their checks to be treated as local they should be willing to use a local payable through bank. They also noted that this proposal would eliminate the operational problems created by the interim rule, by enabling depository banks to rely on the routing number encoded on the check to determine availability.

Miscellaneous issues. Twenty commenters discussed the additional disclosure requirements, with the majority of the commenters opposing them due to the added cost to the depository bank, which would be passed on to bank customers. These commenters also indicated that these extra notices would create additional confusion to their customers. Further, some commenters indicated that it was operationally difficult to provide the added disclosures to their customers because of printing backlogs and quarterly versus monthly statements. The American Bankers Association indicated that the proposed

disclosure requirement was generally an appropriate solution, but suggested additional language that would be applicable to those depository banks that give availability of funds for all checks within the local schedule. Finally, some commenters supported the time frame for disseminating the disclosures.

Eight commenters generally favored the bona fide error proposal, but most asked that additional clarification be provided in § 229.21(c). Some commenters requested that "safe harbor" procedures for determining whether a check is local or nonlocal be identified or examples given with respect to the type of procedure that would be considered reasonable. Further, other commenters believed the provision offered only limited protection and suggested additional language so that depository banks relying on the list of routing numbers of payable through banks compiled by the Federal Reserve would not be liable for related mistakes.

One commenter indicated that it will maintain records of any losses incurred as a result of the payable through amendment and suggested that the Federal Reserve and other banks monitor these matters carefully, so that appropriate action can be taken if losses reach an unacceptable level.

One commenter indicated that the interim amendment was not clear as to what type of checks, other than credit union share drafts, were covered by the amendment, and requested that a more precise identification be given.

One commenter was not in favor of the technical revisions to Regulation CC that were made to conform other provisions of the regulation to the payable through amendment. This commenter requested that the Federal Reserve retain or modify in different ways the provisions that contained references to the use of the routing number versus the actual location of the bank offering payable through checks.

INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Regulatory Flexibility Act (12 U.S.C. 601-612) requires an agency to publish an initial regulatory flexibility analysis with any notice of proposed rulemaking. Two of the requirements of an initial regulatory flexibility analysis (12 U.S.C. 603(b)), a description of the reasons why action by the agency is being considered and a statement of the objectives of, and legal basis for, the proposed rule, are contained in the supplementary material above. The proposed rules require no additional reporting or record-keeping requirements nor are there relevant federal rules that duplicate, overlap, or conflict with the proposed rule.

Another requirement for the initial regulatory flexibility analysis is a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply. The above supplementary material contains the Board's best estimates of the number of institutions that use payable through checks and that would therefore be affected by

the proposed rules. Many of the affected institutions would be small entities, generally credit unions, however the Board does not have information on the sizes of all of the affected entities.

The Board has included in its proposal several alternative rules and is requesting comment on the cost and risk associated with each alternative for all affected entities, both large and small. The Board has not, however, proposed an exemption from coverage for small institutions that use payable through checks. The purpose of the proposed rules is to alleviate the operational difficulties and risk associated with the acceptance of payable through checks by depository 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 proposed to be 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, paragraphs (b)(3) and (b)(4) are revised, and new paragraphs (b)(5), (f), and (g) are added to read as follows:

§ 229.36 -- Presentment and issuance of checks.

* * * * *

(b) * * *

(3) At any branch or head office, if the bank is identified on the check by name without address;

(4) At a branch, head office, or other location consistent with the name and address of the bank on the check if the bank is identified on the check by name and address; or

(5) In the case of a check that is payable by a bank and payable through another bank,

(i) At a location to which delivery is requested by the bank by which the check is payable;

(ii) At any branch or head office of the bank by which the check is payable, if that bank is identified by name without address;

(iii) At any branch, head office, or other location consistent with the name and address of the bank by which the check is payable, if that bank is identified on the check by name and address; or

(iv) At any location described in paragraphs (b)(1) through (b)(4) of this section for the bank through which the check is payable.

* * * * *

(e) [Reserved]

ALTERNATIVE 1.

(f) Presentment of payable through checks.

A check that is payable by a bank and payable through another bank may be presented for payment at any of the locations set forth in paragraph (b)(5)(i)-(iii) of this section unless the routing number of the bank through which the check is payable is associated with a location in the same check processing region as the depository bank, in which case the check may only be presented for payment at the location referred to in paragraph (b)(5)(iv) of this section.

ALTERNATIVE 2.

(f) Presentment of payable through checks.

A check that is payable by a bank and payable through another bank may be presented for payment at any of the locations set forth in paragraph (b)(5) of this section.

ALTERNATIVE 1.

(g) Issuance of payable through checks.

A bank that arranges for checks payable by it to be payable through another bank shall require that the routing number printed in magnetic ink characters on each check be associated with an address in the same check processing region as the bank by which the check is payable. This provision shall be effective [one year after its publication as a final rule], and after that date banks that use payable through arrangements must require their customers to use checks that meet the requirements of this provision.

ALTERNATIVE 2.

(g) 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 words "payable through" followed by the name and location of the payable through bank; and

(2) the name, location, and nine-digit routing number of the bank by which the check is payable.

This provision shall be effective [one year after its publication as a final rule], and after that date banks that use payable through arrangements must require their customers to use checks that meet the requirements of this provision.

ALTERNATIVE 3.

(g) Issuance of payable through checks.

A bank that arranges for checks payable by it to be payable through another bank shall require that:

(1) the routing number printed in magnetic ink characters on each check be associated with an address in the same check processing region as the bank by which the check is payable; and

(2) the following information is printed conspicuously on the face of the check:

(i) the words "payable through" followed by the name and location of the payable through bank; and

(ii) the name and location of the bank by which the check is payable.

This provision shall be effective [one year after its publication as a final rule], 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 depository bank through the payable through bank as quickly as would have been required had the bank by which the check is payable been the bank to which the check was sent for payment. 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 second paragraph of paragraph (b), by adding a new paragraph (b)(5) immediately after paragraph (b)(4), and by adding new paragraphs (f) and (g).

Appendix E -- Commentary

* * * * *

Section 229.36 Presentment and issuance of checks

* * * * *

(b) * * *

The paragraph specifies the locations at which checks are considered received by the paying bank. Where the check is payable through a bank and the check is sent to that bank, the payable through bank is the paying bank for purposes of this subpart, regardless of whether the paying bank must present the check to another bank or to a nonbank payor for payment. If, however, the payable through check is payable by a bank and sent to that bank, the bank by which the check is payable is the paying bank.

* * * * *

5. If a check is payable by a bank and payable through another bank, the check is considered received by the paying bank upon delivery to any location described in paragraphs 1, 3, or 4 above for the bank by which the check is payable. If such a check is sent to the

payable through bank for payment and therefore the payable through bank is the paying bank with respect to that check, it is also considered received by the paying bank upon delivery to any location described in paragraphs 1, 2, 3, or 4 above for the bank through which the check is payable.

* * * * *

(e) [Reserved]

ALTERNATIVE 1.

(f) Presentment of payable through checks.

This paragraph authorizes a depository or collecting bank to present a check that is payable by a bank, and payable through another bank, directly to the bank by which the check is payable unless the check is payable through a local bank, in which case the check must be presented to the local payable through bank.

ALTERNATIVE 2.

(f) Presentment of payable through checks.

This paragraph authorizes a depository or collecting bank to present a check that is payable by a bank, and payable through another bank, directly to the bank by which the check is payable. A bank may also present such a check to the payable through bank. Presentment of such checks may take place at any of the locations set forth in § 229.36(b)(5).

ALTERNATIVE 1.

(g) Issuance of payable through checks.

This paragraph provides that if a bank arranges for a check

payable by it to be payable through another bank, that check must bear a routing number in its MICR line associated with an address at which presentment may be made in accordance with § 229.36(b) that is in the same check processing region as the bank by which the check is payable. Under this requirement, the check could bear the routing number of the bank by which it is payable or the routing number of a local payable through bank. The address associated with the routing number of the bank by which the check is payable could function as an intercept point from which the check could be forwarded to a nonlocal payable through bank.

This provision takes effect one year after its publication as a final rule. The bank by which these checks are payable is responsible for requiring its customers to meet the new requirements after the effective date.

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.

ALTERNATIVE 2.

(g) Issuance of payable through checks.

This paragraph requires that if a bank arranges for a check payable by it to be payable through another bank, that check must contain conspicuously on its face the name, location, and 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 routing number need not be in the MICR line. The required information is presumed to be conspicuous if it is in a type not smaller than six-point type.

This provision takes effect one year after its publication as a final rule. The bank by which these checks are payable is responsible for requiring its customers to meet the new requirements after the effective date.

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.

ALTERNATIVE 3.

(g) Issuance of payable through checks.

This paragraph provides that if a bank arranges for a check payable by it to be payable through another bank, that check must bear a routing number in its MICR line associated with an address at which presentment may be made in accordance with § 229.36(b) that is in the same check processing region as the bank by which the check is payable. Under this requirement, the check could bear the routing number of the bank by which it is payable or the routing number of a local payable through bank. The address associated with the routing number of the bank by which the check is payable could function as an intercept point from which the check could be forwarded to a nonlocal payable through bank.

This paragraph also requires that if a bank arranges for a check payable by it to be payable through another bank, that check must contain conspicuously on its face the name, location, and 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 routing number need not be in the MICR line. The required information is presumed to be conspicuous if it is in a type not smaller than six-point type.

This provision takes effect one year after its publication as a final rule. The bank by which these checks are payable is responsible for requiring its customers to meet the new requirements after the effective date.

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 depository 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 depository 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 paragraph (d) as paragraph (d)(1); by adding a heading for paragraph (d); by adding a new paragraph (d)(2) to follow the third paragraph of newly redesignated paragraph (d)(1); and by revising the last paragraph of paragraph (d) to read as follows:

Section 229.38 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 will be liable for damages under paragraph (a) to the extent that the check is not returned through the payable through bank as quickly as would have been required under § 229.30 had the check been sent to the bank by which it is payable for payment. - This responsibility does not include

responsibility for the time required for the forward collection of a check.

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, October 25, 1988.

William W. Wiles
Secretary of the Board

FEDERAL RESERVE SYSTEM

[Docket No. R-0643]

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 as a final rule, with minor technical changes, the interim amendment to Regulation CC it adopted in August. The Board adopted the interim rule to conform the definition of "paying bank" in Regulation CC to the Expedited Funds Availability Act as interpreted by a court decision. The court found that in defining a payable through bank as the paying bank where a check is written on one bank but payable through another, Regulation CC was inconsistent with the language of the Act.

EFFECTIVE DATE: October 25, 1988.

FOR FURTHER INFORMATION CONTACT: Joseph R. Alexander, Senior Attorney (202/452-2489), Stephanie Martin, Attorney (202/452-3198), Legal Division; Louise L. Roseman, Assistant Director, Division of Federal Reserve Bank Operations (202/452-3874); Kathleen Brueger, Staff Attorney, Division of Community and Consumer Affairs (202/452-2412). 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 issued its Regulation CC -- Availability of Funds and Collection of Checks (12 CFR Part 229) to implement the Expedited Funds Availability Act (the "Act") (Title VI of Pub. L. 100-86). 53 FR 19373 (May 27, 1988). In keeping with the Board's view that the Act established a clear link between the time it normally takes a check to be cleared and returned, and the time within which the depository bank¹ must make the funds available to the depositor, the regulations provided that where a check is payable by one bank but payable through² another and sent to the payable through bank for payment or collection, the location of the payable through bank would determine whether a check is local or nonlocal vis-a-vis the depository bank for the purposes of the funds availability schedules in the regulation.

¹ The Act uses the term "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). Because the term "receiving depository institution" is unique to the Act, the Board used the term "depository bank," which, because it is used in the Uniform Commercial Code ("U.C.C.") and the Board's Regulation J (12 CFR Part 210), is familiar to the banking industry.

² When a check states on its face that it is "payable through" a bank, that bank is referred to as the "payable through bank." Under the U.C.C., a payable through bank is not named as the payor, but is designated as a "collecting bank to make presentment." U.C.C. § 3-120. Under the Board's Regulation J, a payable through bank is the "paying bank." 12 CFR 210.2(j).

Shortly after the Board issued Regulation CC, a trade association of credit unions and one credit union whose checks are payable through a nonlocal bank filed suit against the Board seeking to overturn the definition of paying bank to the extent that the definition included a payable through bank where the check was drawn on a credit union. The court granted the plaintiffs' motion for summary judgment and invalidated Regulation CC's definition of paying bank to the extent that it includes a payable through bank where the check is drawn on a credit union. Credit Union National Association v. Board of Governors, No. 88-1295 OG (D.D.C. July 28, 1988). The court found that the Board's regulation was inconsistent with the Act to the extent that it defined the payable through bank as the paying bank for purposes of the Act's funds availability requirements.

The Act and Regulation CC took effect five weeks after the court rendered its decision. In order to clarify the duties of banks and others in light of the court's order, the Board issued temporary conforming amendments to Regulation CC. The Board also requested comment on the interim rules pending the Board's consideration of a final rule. 53 FR 31290 (August 18, 1988).

The interim rule primarily affected the definitions and the disclosure rules. Where a check is payable by one bank but payable through another bank, the interim rule provided that the check would be considered local or nonlocal by reference to the

location of the payor bank, not by reference to the payable through bank. The interim rule did not affect payable through checks payable by nonbank payors. Further, as payable through checks bear the routing number of the payable through bank, not the payor, provisions in Regulation CC that allowed a depository bank to rely on the routing number to determine whether a check is local or nonlocal were amended. The interim rule also permitted banks whose initial disclosures were affected by the court's decision to comply with the Act by sending to their customers simple clarifying notices in regularly scheduled meetings.

Approximately 93 percent of the 155 comments the Board received on the interim rule objected to the treatment of bank payable through checks as local or nonlocal based on the location of the payor bank, because the rule creates operational difficulties and increases risks for depository banks. Many of the commenters suggested means of addressing these operational problems and risks. In a related action today, the Board has requested comment on several proposals to alleviate these operational problems and risks. (See Docket No. R-0648.)

After consideration of the comments, the Board has determined to adopt in final form the interim rule with two technical changes:

(1) To insert the word "or" after the fourth element in the definition of "paying bank," and

(2) Clarify in the disclosure rules and the Commentary that a bank that makes funds available within the time periods required for local checks is not required to make the special disclosure.

List of Subjects in 12 CFR Part 229

Banks, Banking, Federal Reserve System.

Accordingly, the interim rule amending Regulation CC, 12 CFR Part 229, which was published at 53 FR 31290-31296 on August 18, 1988, is adopted as a final rule with the following changes:

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. Section 229.2(z)(4) is revised to read as follows:

§ 229.2 Definitions.

* * * * *

(z) * * *

(4) The bank through which a check is payable and to which it is sent for payment or collection, if the check is not payable by a bank; or

* * * * *

§ 229.16 [Amended]

3. Section 229.16(b)(2) is amended by adding after the first sentence of the footnote the following new sentence to read as follows:

1 * * * A bank that makes funds from nonlocal checks available for withdrawal within the time periods required for local checks under §§ 229.11, 229.12, and 229.13 is not required to provide this disclosure on payable through checks to its customers. * * *

4. Appendix E -- Commentary to Part 229, is amended by adding following the fourth paragraph of the Commentary to § 229.16(b) a new paragraph to read as follows:

APPENDIX E -- COMMENTARY

* * * * *

SECTION 229.16 SPECIFIC AVAILABILITY POLICY DISCLOSURES

* * * * *

(b) * * *

Generally, a bank that distinguishes in its disclosure between local and nonlocal checks based on the routing number on the check must disclose to its customers that certain checks, such as some credit union payable through drafts, will be treated as local or nonlocal based on the location of the bank by which they are payable (e.g., the credit union), and not on the basis of the location of the bank whose routing number appears on the check. A bank is not required to provide this disclosure, however, if it makes the proceeds of both local and nonlocal checks available

for withdrawal within the time periods required for
local checks in §§ 229.11, 229.12, and 229.13.

* * * * *

By order of the Board of Governors of the Federal
Reserve System, October 25, 1988.

William W. Wiles
Secretary of the Board