FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

DALLAS, TEXAS 75222

April 21, 1989

Circular 89-27

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

## SUBJECT

**Delayed disbursement of teller's checks and cashier's checks**

## DETAILS

The Federal Reserve Board of Governors has issued a policy statement regarding the delayed disbursement of teller's checks and cashier's checks consistent with the purpose of the Expedited Funds Availability Act. The statement addresses abuses of delayed disbursement that may give rise to check float while allowing for legitimate centralized teller's check services.

Delayed disbursement is the practice of issuing checks that are payable by a bank located in a geographic area such that collection of the checks is generally delayed. This practice increases the time and cost for a bank to collect the checks. The effects of delayed disbursement are particularly significant in the case of teller's checks and cashier's checks, which must be given next-day availability under the Expedited Funds Availability Act and Regulation CC.

Major providers of teller's and cashier's checks have indicated to that Board that they are willing to make operational changes to speed the collection of checks in the markets they serve. The Board will monitor adherence to the policy and delayed disbursement practices in general and, if necessary, may reconsider whether formal regulatory action may be warranted.

## ATTACHMENTS

The Board's policy statement is attached.

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).

## MORE INFORMATION

For further information, please contact Robert L. Whitman, (214) 698-4357 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 Wallace

FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Docket No. R-0639]

Policy Statement -- Delayed Disbursement of Teller's Checks and Cashier's Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy Statement.

SUMMARY: The Board is issuing a policy statement regarding the delayed disbursement of teller's checks and cashier's checks consistent with the purpose of the Expedited Funds Availability Act. The policy statement is intended to address abuses of delayed disbursement that may give rise to check float while allowing for legitimate centralized teller's check services.

EFFECTIVE DATE: April 10, 1989.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202/452-3874), or Gayle Thompson, Program Leader (202/452-2934), Division of Federal Reserve Bank Operations; Oliver Ireland, Associate General Counsel (202/452-3625), or Stephanie Martin, Attorney (202/452-3198), Legal Division; for the hearing impaired only: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

**The Delayed Disbursement Problem**

Delayed disbursement is the practice of issuing checks that are payable by, through, or at a bank[1/] located in a geographic area such that collection of the checks is generally delayed. In addition to increasing the time for the collection and return of a check, delayed disbursement often increases the costs to process and transport the check. Delayed disbursement practices not only reduce the efficiency of the check collection system, but may also increase the risk to the depositary bank because the delay may result in a check being returned after funds must be made available for withdrawal under the Expedited Funds Availability Act ("Act") and the Board's Regulation CC (12 CFR Part 229).

**Delayed Disbursement of Teller's Checks**

Although many classes of checks are subject to delayed disbursement, the effects of delayed disbursement are particularly significant in the case of teller's checks[2/]. Many banks issue teller's checks in lieu of cashier's checks (i.e., checks a bank draws on itself). These banks believe that, due to

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[1/]Regulation CC defines "bank" to include all depository institutions, including commercial banks, savings and loan associations, and credit unions. A depositary bank is defined as the first bank to which a check is transferred. A paying bank is a bank by, at, or through which a check is payable and to which it is sent for collection.

[2/]Regulation CC defines a "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 another bank. For the purposes of the proposed amendments to Regulation CC as well as this policy statement, "teller's check" includes checks drawn on a Federal Reserve Bank or a Federal Home Loan Bank. Regulation CC defines "cashier's check" as a check provided to a customer of a bank, or acquired from a bank for remittance purposes, that is drawn on the bank, is signed by an officer or employee of the bank on behalf of the bank as drawer, and is a direct obligation of the bank.

specialization and economies of scale, certain banks and other service providers can perform the tracking, reconciliation, and payment of teller's checks at a lower cost than the issuing bank would incur by issuing and paying cashier's checks. In addition, in certain cases, based on the location of the paying bank vis-a-vis the issuing bank[3], the issuing bank can accrue float benefits from the delayed disbursement of these checks.[4]

The Act requires a depositary bank to provide customers with next-day availability, under specified conditions, for certain checks, including cashier's checks and teller's checks, deposited in transaction accounts. Regulation CC extends this next-day availability requirement to checks drawn on Federal Reserve Banks and Federal Home Loan Banks, because these checks have a low risk of return and are often used as a substitute for teller's checks. Depending on the location of the paying bank, a depositary 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 bank issuing such checks to impose costs, in terms of lost interest, on other

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[3] Based on a recent Federal Reserve Bank survey, staff estimates that approximately 60 to 80 percent of teller's and cashier's checks are deposited in a bank that is located in the same state as the issuing bank. Thus, when banks issue teller's checks that are payable at a location distant from the issuing bank, the depositary bank is also generally distant from the paying bank.

[4] In some cases, the issuing bank does not remit funds to the paying bank until the day of presentment. In other cases, the issuing bank remits funds to the paying bank before the check is presented. Such funds may be held in a compensating balance account by the paying bank until the check is presented for payment. Earnings from the compensating balance account may be used to offset fees for teller's check services.

banks and to benefit from interest or earnings credits earned on outstanding checks until the checks are presented for collection.

**Previous Board Actions**

Prior to enactment of the Act, the Board's ability to address delayed disbursement abuses was limited to discouraging such practices through policy statements[5] and Federal Reserve Bank services, such as the High-Dollar Group Sort program. The 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)). The Act also evidences the Congress' intent to speed the availability of funds to bank depositors and, thus, suggests that a reevaluation of delayed disbursement practices is appropriate.

In December 1987, the Board requested public comment on proposed Regulation CC as well as on proposals for long-term improvements to the check collection system (52 FR 47176, December 11, 1987). A number of commenters on proposed Regulation CC cited the inequity of requiring the depositary bank to make the proceeds of certain checks, including teller's checks, available for withdrawal on the business day after deposit if the bank cannot receive credit for the checks by that time. Some commenters recommended that the Board restrict the

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[5]See policy statements issued by the Board on January 11, 1979 and February 23, 1984.

next-day availability requirement to checks for which the depositary bank can receive credit by the next business day. Such a restriction, however, would be inconsistent with the Act.

With respect to longer term improvement in the check collection system, the Board requested comment on how to address delayed disbursement practices and the practice of issuing teller's checks payable in a different check processing region than that of the issuing bank. The majority of comments that addressed this issue indicated that the practice of issuing teller's checks payable in a different check processing region should be eliminated. Several other commenters (primarily providers of teller's check services) opposed any regulatory action to limit the location of the paying bank.

After an analysis of the comments, the Board issued for comment in June 1988 a proposed amendment to Regulation CC to restrict certain delayed disbursement practices, with a proposed effective date of April 1, 1989 (53 FR 24093, June 27, 1988). Under the proposal, a bank that issued teller's checks would be required to draw the checks on or designate the checks payable through or at a bank such that a depositary bank located in the same community as the issuing bank would generally receive credit for the check as quickly as it would receive credit on a check drawn on the issuing bank.

This proposed "equivalent availability" rule was based on the actual check collection practices of banks in the issuing bank's community. The Board did not believe it was practical to address the cases in which teller's checks are deposited in banks distant from the issuing bank, such that the depositary banks are unable to receive next-day credit for the checks, even though the depositary banks must make the funds available for withdrawal on the next business day. For those checks deposited in a bank local to the issuing bank, the proposed rule was designed to ensure that depositary banks generally would receive credit for the teller's check by the next business day, when the funds must be made available for withdrawal.

**Public Comment On Delayed Disbursement Proposal**

The Board received over 230 written comments from the public, and Board staff held numerous informal conversations with industry representatives regarding the effects of the proposal. Over 75 percent of the commenters supported the Board's objective to restrict the delayed disbursement of teller's checks; however, commenters indicated that the proposed rule was unclear and would be difficult to administer. Commenters expressed particular concerns about how issuers of teller's checks and providers of teller's check services could determine whether banks in a given community collected checks such that the availability of the teller's checks would be equivalent to the availability the banks receive on checks drawn on the issuing bank.

As an alternative to the proposal, some commenters suggested that a cutoff hour, such as a Federal Reserve deposit deadline, be established such that a check deposited by the depositary bank for collection at or after the cutoff hour would receive next-day credit. Several commenters indicated that a combination of Federal Reserve and correspondent deadlines should be referenced to determine whether an issuing bank could issue teller's checks of a particular service provider. Other commenters suggested that the delayed disbursement problem could be resolved, in large part, by requiring that teller's checks be payable locally, or be encoded with a city routing number if payable nonlocally.[6]

The Board has reviewed the public comments received and has evaluated alternative methods of dealing with the delayed disbursement of teller's checks. It has considered the costs of delayed disbursement on depositary banks and the burdens on users of teller's check services that might occur should the Board take regulatory action. The Board believes that by issuing a policy statement it can avoid the rigidity of a regulation and still address the problem of intentional delay in the collection of teller's checks. The effectiveness of the policy statement, however, will depend on the cooperation of teller's check issuers and service providers. Discussions with the major providers of teller's check services indicated that they are willing to make changes that would speed the collection of checks in markets they serve. The Board has received commitments from a number of major teller's check providers to make operational changes that would address in large part the concerns that prompted the Board to propose amendments to Regulation CC to restrict the delayed disbursement of these checks.

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[6] Commenters also expressed concern regarding the proposed effective date of April 1, 1989. Commenters indicated that the proposed rule would require many banks to replace existing teller's check stock or to change providers of teller's check services, thereby necessitating a longer lead time than that provided in the proposal. In response to these comments, the Board issued a notice that should the Board adopt a rule restricting the delayed disbursement of teller's checks, such a rule would not be effective April 1, 1989, as published in the proposal. (54 FR 5495, February 3, 1989).

The Board favors cooperative solutions that do not require rigid regulations and that demonstrate the industry's willingness to work toward payment system improvements. Therefore, the Board is issuing a policy statement in lieu of adopting a final regulation restricting delayed disbursement practices. The effectiveness of the policy statement, however, will depend on the cooperation of teller's check service providers and issuers of teller's checks. The policy statement will be effective immediately, but the Board recognizes that many banks and service providers will need a longer lead time to comply with the policy. The Board will monitor the industry's adherence to the policy statement and delayed disbursement practices in general and, should abuses continue, will consider formal regulatory action.

In light of the foregoing, the Board is issuing the following policy statement:

**Board Policy Statement on Delayed Disbursement of Teller's Checks and Cashier's Checks**

Delayed disbursement is the practice of issuing checks that are payable by, through, or at a bank[1/] located in a geographic area such that collection of the checks is generally delayed. Although many classes of checks are subject to delayed disbursement, the effects of delayed disbursement are

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[1/]Regulation CC defines "bank" to include all depository institutions, including commercial banks, savings and loan associations, and credit unions. A depositary bank is defined as the first bank to which a check is transferred. A paying bank is a bank by, at, or through which a check is payable and to which it is sent for collection.

particularly significant in the case of teller's checks[2]. The delayed disbursement of teller's checks imposes float costs on the depositary bank, which must generally make the proceeds of these checks available for withdrawal on the business day following deposit. In addition, delayed disbursement often increases the costs to process and transport these checks.

The Expedited Funds Availability Act ("Act") and Regulation CC (12 CFR Part 229) require a depositary bank to provide customers with next-day availability, under specified conditions, for certain checks deposited in transaction accounts, including cashier's checks[3] and teller's checks. Depending on the location of the paying bank, a depositary 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 bank issuing such checks to impose costs, in terms of lost interest, on other banks and to benefit from interest or earnings credits earned on outstanding checks until the checks are presented for payment.

The Board recognizes that many banks that issue teller's checks benefit from the specialization and economies of

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[2] Regulation CC defines a "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 another bank. For the purposes of this policy statement, "teller's check" includes checks drawn on a Federal Reserve Bank or a Federal Home Loan Bank.

[3] Regulation CC defines "cashier's check" as a check provided to a customer of a bank, or acquired from a bank for remittance purposes, that is drawn on the bank, is signed by an officer or employee of the bank on behalf of the bank as drawer, and is a direct obligation of the bank.

scale of certain banks and other service providers that can perform the tracking, reconciliation, and payment services associated with teller's checks at a lower cost than the issuing bank would incur by issuing and paying cashier's checks. In addressing the delayed disbursement problem, the Board believes that it is desirable to reduce the float created by the issuance of these checks while at the same time minimize the disruption of efficient teller's check services.

As a general matter, the Board believes that a depositary bank located in the same community as the bank that issues a teller's check should be able to receive next-day credit for the teller's check. The Board has determined, after review of Federal Reserve collection patterns and deposit deadlines across the country, that depositary banks in most areas generally can receive next-day credit for checks that are encoded with a nonlocal city routing number[4] and presented in a nonlocal Federal Reserve city. For checks that are encoded with a nonlocal RCPC or country routing number and presented in a nonlocal check processing region, credit is generally deferred by one or two days. The Board recognizes, however, that depositary banks located on the west coast generally may not be able to receive next-day availability for checks presented in most nonlocal cities. In addition, in other isolated areas of the

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[4] These checks are payable by banks located in the same city as a Federal Reserve office. RCPC ("Regional Check Processing Center") checks are payable by banks in areas designated within the territories of Federal Reserve offices but outside Federal Reserve cities. Certain Federal Reserve regions also contain country zones, which are generally more remote from Federal Reserve cities than are RCPC zones.

country, next-day credit is generally not available for any check payable by a nonlocal paying bank. The Board recognizes that banks in these areas may benefit by having access to a centralized teller's check service provider.

The Board believes that banks issuing teller's checks and teller's check service providers should take steps to ensure that delays in the collection and return of teller's checks are kept to a minimum. First, the Board believes that any disbursement practice designed to extend the time needed to collect a teller's check is inappropriate. Although the Board believes that centralized disbursement is economically efficient in some cases, the location of the paying bank should be chosen so as to minimize collection time.

Second, the Board has determined that depositary banks can generally receive credit faster for checks payable by a bank with a city routing number than for checks payable by a bank with an RCPC or country routing number. The Board believes that teller's check service providers that serve issuing banks in check processing regions that are nonlocal to the paying bank should help speed the collection and return of teller's checks by use of a city presentment point and a city routing number in the MICR line of its teller's checks.

Some teller's check service providers confine the scope of their services to a state or other limited geographic area. Because the state or area may be divided into more than one check processing region, such service providers may use a paying bank that is nonlocal to many of their customer banks. In addition, the state or area may contain no Federal Reserve city. The Board recognizes that it may be impractical for such service providers to use a city presentment point.

Third, the Board believes that those teller's check service providers that serve banks nationwide should accept teller's checks at more than one presentment point, particularly those providers that serve west coast banks. For example, a teller's check service provider that uses an east coast paying bank could shorten collection and return times for its California customers by also providing a west coast presentment point for teller's checks.

The Board recognizes that similar delayed disbursement problems arise in connection with cashier's checks, issued by a bank with multistate branches, that depositary banks must send to a central location for payment. The Board believes that the same general guidelines should apply to the disbursement of cashier's checks as apply to teller's checks and will take further action regarding cashier's checks should abusive delayed disbursement practices continue to occur.

The Board will monitor the industry's adherence to the policy statement and delayed disbursement practices in general and, should abuses continue, will consider formal regulatory action.

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

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

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