



FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS
75265-5906

June 4, 1997

Notice 97-52

TO: The Chief Executive Officer of each
financial institution and others concerned
in the Eleventh Federal Reserve District

SUBJECT

**Proposed Amendments to Regulation J
(Collection of Checks and Other Items by Federal
Reserve Banks and Funds Transfers
Through Fedwire)**

DETAILS

The Board of Governors of the Federal Reserve System is proposing amendments to Regulation J to help ease the transition to interstate branching in the check collection area. Under the proposed amendments, an institution could send checks to any Reserve Bank for collection, but all of its check collection transactions through the Federal Reserve would be reflected in a single account held at its "Administrative Reserve Bank" no matter where the institution has its branches.

The Board must receive comments by July 21, 1997. Please address comments to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0972.

ATTACHMENT

A copy of the Board's notice as it appears on pages 27547-54, Vol. 62, No. 97, of the *Federal Register* dated May 20, 1997, is attached.

MORE INFORMATION

For more information, please contact Jane Anne Schmoker at (214) 922-5101. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

ACTION: Proposed rule.

SUMMARY: Effective January 1, 1998, the Reserve Banks will begin to implement a policy under which each depository institution may maintain only a single funds account with the Federal Reserve. A single account will establish a single debtor-creditor relationship between each institution and a Federal Reserve Bank and will make account management more efficient for banks with interstate branches. The Board is proposing amendments to subpart A of Regulation J to conform the Federal Reserve check collection rules to the single account structure.

DATES: Comments must be submitted on or before July 21, 1997.

ADDRESSES: Comments, which should refer to Docket No. R-0972, may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Comments addressed to Mr. Wiles also may be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m. and to the security control room outside of those hours. Both the mail room and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, N.W. Comments may be inspected in Room MP-500 between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in § 261.8 of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Oliver Ireland, Associate General Counsel, (202/452-3625), Stephanie Martin, Senior Attorney (202/452-3198), or Heatherun Allison, Attorney (202/452-3565), Legal Division. For the hearing impaired *only*, contact Diane Jenkins, Telecommunications Device for the Deaf (TDD) (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION:

Overview

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Pub. L. 103-328) made significant changes to various banking laws to authorize and facilitate interstate banking. Consequently, the number of depository institutions that operate branches in more than one Federal Reserve District is expected to increase. On January 1, 1998, the Federal Reserve Banks will begin to implement a new account structure that will provide a single Federal Reserve account for each

FEDERAL RESERVE SYSTEM

12 CFR Part 210

[Regulation J; Docket No. R-0972]

Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire

AGENCY: Board of Governors of the Federal Reserve System.

institution.¹ A primary objective of the single account structure is to establish a single debtor-creditor relationship between each chartered entity and the Federal Reserve. A single debtor-creditor relationship is the most effective means for Reserve Banks to manage their affairs with a depository institution. A single account structure also may allow depository institutions to manage their overall position with the Reserve Banks more efficiently.

The Board has already requested comment on amendments to Regulations D and I (Reserve Requirements of Depository Institutions and Issue and Cancellation of Capital Stock of Federal Reserve Banks, respectively) to define the location of a depository institution for purposes of reserve accounts and Federal Reserve membership (62 FR 11117, March 11, 1997). The Board is now proposing amendments to subpart A of Regulation J, governing the collection of checks and other items by Federal Reserve Banks, to conform the Federal Reserve check collection rules to the single account structure. The Board does not believe it is necessary to amend subpart B of Regulation J, which governs funds transfers through Fedwire, to accommodate the single account structure. The Reserve Banks will, however, issue revised operating circulars governing collection of cash items, Fedwire funds transfers, and other Reserve Bank services to reflect the new account structure.

Under the proposed Regulation J amendments, all of an institution's check collection transactions through the Federal Reserve Banks would be reflected in a single account held at that institution's "Administrative Reserve Bank" (or in a correspondent's account at a Reserve Bank). The proposed amendments to Regulation D provide a means to determine the location of an institution's reserve account.² Proposed Regulation J would provide that the account location of an institution that sends items to a Reserve Bank for collection (and the identity of its Administrative Reserve Bank) would be

determined in accordance with the provisions of Regulation D, even if the institution is not otherwise subject to that regulation.

Under the proposed amendments, an institution generally would be permitted to send an item to any Reserve Bank for collection, but the item will be deemed to have been sent first to that institution's Administrative Reserve Bank. The proposed amendments would designate the parties that are deemed to handle the item and the order in which they are deemed to have handled it. (Although the Administrative Reserve Bank would be deemed to handle the check, it would not be considered to have "received" the check as that term is used in subpart A of Regulation J if the check is initially sent to another Reserve Bank.) The amendments would require a paying bank to settle for an item with its Administrative Reserve Bank (regardless of whether the institution received the item from its Administrative Reserve Bank) and would specify the time and manner in which the paying bank is to make settlement. The proposed amendments also would make changes in the rules governing the handling of and settlement for returned checks parallel to those proposed for cash items.

Section-by-Section Analysis

Section 210.2 Definitions

The Board proposes to add two new definitions to Regulation J. Under the new account structure, all of an institution's transactions will be reflected in a single account held at the institution's Administrative Reserve Bank. The Board is proposing to add a definition of "account" to mean an account with reserve or clearing balances held on the books of a Federal Reserve Bank. If a depository institution desires, the Reserve Banks will also keep informational records, or subaccounts, of certain subsets of transactions that affect an account (such as the transactions performed by a branch of a bank that may be in another district from the Administrative Reserve Bank).

The Board proposes to define "Administrative Reserve Bank" as the Reserve Bank in whose District the entity in question is located. An entity's location would be determined in the same way as location is determined for purposes of reserve accounts under the Board's Regulation D. (See footnote 2.)

The Board also proposes to amend the definition of "bank" to conform to the Uniform Commercial Code (§§ 4-105 and 4-107). Finally, the Board proposes to amend the definition of "cash item"

to provide that, under the new single-account system, the Reserve Bank that initially receives an item for deposit, rather than the Reserve Bank in whose District the item is payable, is the Reserve Bank that decides whether to accept the item as a cash item.

Section 210.3(a) General Provisions

This paragraph provides that the Reserve Banks may issue operating circulars governing the details of their check collection services and related matters. The Board proposes to specify that the operating circulars may allow an Administrative Reserve Bank to give instructions to other Reserve Banks, such as instructions regarding the handling of items that would affect an account on its books.

Section 210.4 Sending Items to Reserve Banks

The Board proposes to amend this section to provide that a sender (other than a Reserve Bank sender) may send an item to any Reserve Bank for collection, regardless of where the sender or the paying bank is located. This amendment would provide flexibility for depository institutions, foster competition among Reserve Banks, and promote faster collection of checks. For example, a bank with its head office in Richmond would likely have its account at the Federal Reserve Bank of Richmond. An Iowa branch of that bank may wish to send its checks to the Federal Reserve Bank of Chicago or the Federal Reserve Bank of Kansas City, or both, all of which would be permissible under the proposed rule. The sender's Administrative Reserve Bank (the Federal Reserve Bank of Richmond in this example), however, may override this rule and require the sender to send the item to a particular Reserve Bank. For example, if a bank is in financial difficulty, the Administrative Reserve Bank may want to require the bank to deposit all of its items directly with a particular Reserve Bank in order to retain closer control over the bank's account.

Section 13(1) of the Federal Reserve Act (FRA)³ authorizes a Reserve Bank to accept deposits of checks and other items from its member banks or from other depository institutions and to accept from other Reserve Banks checks and other items payable within its District. Under the Board's proposal, if a sender sends a check to a Reserve Bank other than its Administrative Reserve Bank or the Reserve Bank in whose District the check is payable, the receiving Reserve Bank would be

¹ A foreign bank's U.S. branches and agencies and an Edge or agreement corporation's offices will not be required to adopt a single account structure.

² The proposed Regulation D provision would provide that a depository institution is considered to be located in the Federal Reserve District specified in the institution's charter or organizing certificate, or, if no such location is specified, the location of its head office. If that location, in the Board's judgment, is ambiguous or would impede the ability of the Board or the Federal Reserve Banks to perform their functions under the Federal Reserve Act, the Board could make exceptions to the general rule for a particular institution after considering certain criteria.

³ 12 U.S.C. 360.

deemed to be acting as agent of the Administrative Reserve Bank. Proposed Regulation J would require, however, that such a receiving Reserve Bank take on additional rights, duties, and liabilities in its own name that it would not necessarily have as a common law agent of the Administrative Reserve Bank. For example, the receiving Reserve Bank would be considered an indorser on the check and would make warranties on the check under § 210.6, Regulation CC, and the Uniform Commercial Code in its own name. The Board believes that requiring such a receiving Reserve Bank to take on these rights, duties, and liabilities is necessary to preserve a clear chain of warranties and other claims in the check collection and return system. Currently, in those limited situations where a Reserve Bank accepts deposits from institutions other than those located in its District, it does so under a special agency agreement with the institution's home Reserve Bank. Rather than perpetuating these special agreements, the Board proposes to amend Regulation J to establish the terms under which the receiving

Reserve Bank would handle items on behalf of an Administrative Reserve Bank.

Specifically, the proposed amendments to § 210.4 would designate the parties that are deemed to handle an item and the order in which they are deemed to have handled the item. These amendments would establish the chain of indorsements on an item under Regulation J, Regulation CC, and the Uniform Commercial Code, as well as the order in which the parties are agents or subagents of the owner of an item, as provided in § 210.6(a). As noted above, the proposal provides that the sender is deemed to send the item to its Administrative Reserve Bank, regardless of whether that Reserve Bank actually receives the item first. The Administrative Reserve Bank is deemed to send the item to the Reserve Bank that actually receives the item from the sender (if different from the Administrative Reserve Bank). Any subsequent Reserve Bank that receives the item from another Reserve Bank is deemed to handle the item in turn.

In the example from the previous paragraph, where an Iowa branch of a

Richmond bank sends a check to the Chicago Reserve Bank for collection, the check would be deemed handled in the following order: the initial sender, the Richmond Reserve Bank (the Administrative Reserve Bank), and the Chicago Reserve Bank (the first Reserve Bank to receive the item). If the check in this example were drawn on a banking office in New York, the Chicago Reserve Bank would send the check to the Federal Reserve Bank of New York, in which case the New York Reserve Bank would be the last Reserve Bank to handle the check and would present the check to the paying bank. No other Reserve Bank would handle or would be deemed to handle the item. In the example, if the paying bank's Administrative Reserve Bank is the Federal Reserve Bank of Boston (which might be the case if the check is payable by a New York office of a bank headquartered in Boston), the Boston Reserve Bank is not a party to the check, even though settlement for the check will ultimately take place by a debit to an account on the Boston Reserve Bank's books. (See Table 1.)

Table 1

This table illustrates the following example:

A Richmond-based bank has its account at the Federal Reserve Bank of Richmond (Richmond Fed), its Administrative Reserve Bank. An Iowa branch of the bank sends a check to the Federal Reserve Bank of Chicago (Chicago Fed) for collection. The check is payable by a New York office of a Boston-based bank, which has an account at the Federal Reserve Bank of Boston (Boston Fed). The Chicago Fed sends the check to the Federal Reserve Bank of New York (NY Fed), which presents the check to the New York office of the paying bank.

Path of physical check

Initial sender → Chicago Fed → NY Fed → Paying Bank

Parties deemed to have handled the check (Chain of indorsements)

Initial sender → Richmond Fed → Chicago Fed → NY Fed → Paying Bank

Section 210.5 Sender's Agreement; Recovery by Reserve Bank

Paragraph (a) of § 210.5 sets forth the terms and warranties to which a sender agrees when it sends an item to a Reserve Bank. The Board is proposing to amend this paragraph to conform with the provisions of § 210.4. Specifically, a sender would authorize its Administrative Reserve Bank, as well as any other Reserve Bank to which the item is sent, to handle an item and would authorize the Reserve Banks to make the appropriate accounting entries in settlement for the item. The Board proposes to make minor amendments to paragraph (c) (and parallel amendments to § 210.12(f)), which would simplify the provisions describing how settlements occur between Reserve Banks. The Board also proposes to redesignate the paragraph numbers in paragraph (c).

Paragraph (d) of § 210.5 requires a sender to grant a security interest in all its assets held by a Reserve Bank to secure any of its obligations related to items collected through the Reserve Banks. The Board proposes to amend this section to provide that the security interest is granted to the sender's Administrative Reserve Bank.

Section 210.6 Status, Warranties, and Liability of Reserve Bank

Paragraph (a) of this section provides that Reserve Banks act as agents or subagents of the owner of an item. The Board proposes to modify the reference to a Reserve Bank in the first sentence with the phrase "that handles an item" to clarify that this paragraph refers to the Reserve Banks that are identified in proposed § 210.4. The current language provides that the agency terminates when a Reserve Bank receives final payment for the item and makes the

proceeds available for use by the sender. The Board proposes to amend this provision by stating that the agency status will not end unless the time for commencing all actions against the Reserve Bank has expired. This amendment would ensure that the agency and subagency relationships between Reserve Banks regarding a particular item, as set forth in proposed § 210.4, will continue until the statute of limitations has run on claims regarding any dispute concerning the item. The Board also proposes to reorganize the numbering in paragraphs (a) and (b) of this section.

Section 210.7 Presenting Items for Payment

This section provides rules regarding the presentment of items for payment. The Board proposes to make minor changes to paragraphs (c) and (d). Rather than referring to an item that is

“payable” in a certain Federal Reserve District, the Board proposes to refer to items that may be “sent to the paying bank or nonbank payor” in a certain Federal Reserve District. The Board believes the proposed language is more precise than the current provision.

Section 210.8 Presenting Noncash Items for Acceptance

Similar to the proposed changes to § 210.7, the Board is proposing to replace the term “payable elsewhere” with the term “may be presented elsewhere.” The Board also proposes to reorganize the paragraph numbering in this section.

Section 210.9 Settlement and Payment

This section sets forth the time and manner by which a paying bank must settle for items it receives from a Reserve Bank. The Board proposes to add a new paragraph (a) (and to redesignate the following paragraphs accordingly) to provide that a paying bank must settle for an item with its Administrative Reserve Bank, whether or not the paying bank actually receives the item from that Reserve Bank. By settling with its Administrative Reserve Bank, the paying bank would meet any settlement obligation it may have under Regulation CC and the Uniform Commercial Code. For example, the Uniform Commercial Code (§§ 4-301 and 4-302) requires a paying bank to settle with the presenting bank by midnight on the day of presentment if it wants to preserve its right to return the check by its midnight deadline on its next banking day. By settling with its Administrative Reserve Bank, a paying bank would satisfy this obligation to a presenting Reserve Bank.

The new paragraph (a) would also provide that a paying bank may settle through a correspondent account, with the agreement of its Administrative Reserve Bank, the Reserve Bank (if different) that holds the correspondent’s account, and the correspondent. The paying bank would remain responsible for settlement if for some reason settlement does not occur through the correspondent account. The Board proposes to make a conforming change to paragraph (c) (as redesignated) related to payment for noncash items.

Currently, Regulation J requires the paying bank to settle so that funds are available to the presenting Reserve Bank by the close of Fedwire on the day of presentment. The Board proposes: (1) amendments to paragraph (b) (as redesignated) of § 210.9 to clarify that settlement funds must be made available to the paying bank’s Administrative Reserve Bank, rather

than the presenting Reserve Bank; (2) to change the references to a Reserve Bank’s operating circular to include all of the Reserve Banks’ operating circulars, as those circulars will be uniform as of January 1, 1998; (3) to clarify paragraph (b)(3) to refer to days the paying bank is closed voluntarily “so that it does not receive a cash item” (the provisions of this paragraph would not apply if the paying bank’s head office were closed for business but a branch still received presentment of cash items from the Reserve Banks); (4) to replace references to “one hour after the scheduled opening of Fedwire” with “9:30 a.m. Eastern Time” so that this time will remain unchanged when the Fedwire opening hour is moved to 12:30 a.m. in December 1997; (5) to add paragraph headings throughout paragraph (b); and (6) to make conforming changes to cross-references throughout § 210.9 in light of the paragraph redesignations.

Section 210.10 Time Schedule and Availability of Credits for Cash Items and Returned Checks

This paragraph provides that a Reserve Bank shall make proceeds available for cash items and returned checks according to its published time schedules. The proposed amendments to this section would clarify that the Reserve Bank that holds the settlement account will make credit available according to the time schedule of the Reserve Bank that first receives the cash item (or returned check) from the sender (or the paying or returning bank). The Board also proposes a conforming amendment to § 210.11(b) regarding credit for noncash items.

Section 210.12 Return of Cash Items and Handling of Returned Checks

This section sets forth the rules governing handling of and settlement for returned checks. The rules for returned checks are generally parallel to the rules for cash items, and the Board is proposing amendments that are parallel to the amendments for cash items discussed above. Under the proposal, a paying bank or returning bank may send a returned check to any Reserve Bank, unless its Administrative Reserve Bank directs it to send the returned check to a specific Reserve Bank. As with cash items, the paying or returning bank’s Administrative Reserve Bank would be deemed to have handled the item first, prior to the Reserve Bank that actually received the item, for purposes of determining the relationships, rights, and liabilities of the parties (see discussion of § 210.4). Also similar to cash items, a paying or

returning bank would authorize the handling of a returned check by its Administrative Reserve Bank, as well as by any other Reserve Bank to which a returned check is sent, and would authorize the Reserve Banks to make the appropriate accounting entries in settlement for the returned check (see discussion of § 210.5). A subsequent returning bank or depository bank would be required to settle for a returned check with its Administrative Reserve Bank, whether or not the bank actually receives the returned check from that Reserve Bank. By settling with its Administrative Reserve Bank, the subsequent returning bank or depository bank would meet its settlement obligations under Regulation CC and the Uniform Commercial Code (see discussion of § 210.9(a)). Finally, a paying or returning bank would grant a security interest in all its assets held by its Administrative Reserve Bank to secure any of its obligations related to returned checks it sends to a Reserve Bank (see discussion of § 210.5(d)).

Initial Regulatory Flexibility Analysis

The Regulatory Flexibility Act (5 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 (5 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 rule requires no additional reporting or recordkeeping requirements and does not overlap with other federal rules. Regulation J bears a close relationship with the Board’s Regulation CC (12 CFR part 229), and that relationship is explained in the supplementary information above as well as in the provisions of the two regulations.

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 proposal will apply to all institutions, regardless of size, that send checks, returned checks, or other items to a Reserve Bank or receive items from a Reserve Bank. In 1996, subsidiaries of the 100 largest bank holding companies deposited approximately 46 percent of the Federal Reserve Banks’ check volume, and all other banks deposited 54 percent. The Reserve Banks presented approximately 31 percent of their check volume to subsidiaries of the 100 largest bank holding companies,

and 69 percent to all other banks. The proposed rule sets out the terms under which the Reserve Banks handle items and do not impose significant burdens on small institutions.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the proposed rule.

List of Subjects in 12 CFR Part 210

Banks, banking, Federal Reserve System.

For the reasons set out in the preamble, the Board proposes to amend part 210 of chapter II of title 12 of the Code of Federal Regulations as set forth below:

PART 210—COLLECTION OF CHECKS AND OTHER ITEMS BY FEDERAL RESERVE BANKS AND FUNDS TRANSFERS THROUGH FEDWIRE (REGULATION J)

1. The authority citation for part 210 continues to read as follows:

Authority: 12 U.S.C. 248(i), (j), and (o), 342, 360, 464, and 4001–4010.

2. Section 210.2 is amended by redesignating paragraph (a) and paragraphs (b) through (p) as paragraph (b) and paragraphs (d) through (r), respectively; adding new paragraphs (a) and (c); and revising newly redesignated paragraphs (d), (g) introductory text, and (g)(2) to read as follows:

§ 210.2 Definitions.

* * * * *

(a) *Account* means an account with reserve or clearing balances on the books of a Federal Reserve Bank. A subaccount is an informational record of a subset of transactions that affect an account and is not a separate account.

* * * * *

(c) *Administrative Reserve Bank* with respect to an entity means the Reserve Bank in whose District the entity is located, as determined under the procedure described in § 204.3(b)(2) of this chapter (Regulation D), even if the entity is not otherwise subject to that section.

* * * * *

(d) *Bank* means any person engaged in the business of banking. A branch or separate office of a bank is a separate bank to the extent provided in the Uniform Commercial Code.

* * * * *

(g) *Cash item* means—

* * * * *

(2) Any other item payable on demand and collectible at par that the Reserve Bank that receives the item is willing to accept as a cash item. *Cash item* does not include a returned check.

* * * * *

3. In § 210.3, the last sentence of paragraph (a) is revised to read as follows:

§ 210.3 General provisions.

(a) *General.* * * * The circulars may, among other things, classify cash items and noncash items, require separate sorts and letters, provide different closing times for the receipt of different classes or types of items, provide for instructions by an Administrative Reserve Bank to other Reserve Banks, set forth terms of services, and establish procedures for adjustments on a Reserve Bank's books, including amounts, waiver of expenses, and payment of interest by as-of adjustment.

* * * * *

4. Section 210.4 is revised to read as follows:

§ 210.4 Sending items to Reserve Banks.

(a) *Sending of items.* A sender, other than a Reserve Bank, may send any item to any Reserve Bank, whether or not the item is payable within the Reserve Bank's District, unless the sender's Administrative Reserve Bank directs the sender to send the item to a specific Reserve Bank.

(b) *Handling of items.* (1) The following parties, in the following order, are deemed to have handled an item that is sent to a Reserve Bank for collection—

- (i) The initial sender;
- (ii) The initial sender's Administrative Reserve Bank;
- (iii) The Reserve Bank that receives the item from the initial sender (if different from the initial sender's Administrative Reserve Bank); and
- (iv) Another Reserve Bank, if any, that receives the item from a Reserve Bank.

(2) A Reserve Bank that is not described in paragraph (b)(1) of this section is not a party that handles an item and is not a collecting bank with respect to an item.

(3) The identity and order of the parties under paragraph (b)(1) of this section determine the relationships and the rights and liabilities of the parties under this subpart, part 229 of this chapter (Regulation CC), and the Uniform Commercial Code. An initial sender's Administrative Reserve Bank that is deemed to handle an item is also deemed to be a sender with respect to

that item. The Reserve Banks that are deemed to handle an item are deemed to be agents or subagents of the owner of the item, as provided in § 210.6(a) of this subpart.

(c) *Checks received at par.* The Reserve Banks shall receive cash items and other checks at par.

5. In § 210.5, paragraphs (a)(1) and (c) and the first sentence of paragraph (d) are revised to read as follows:

§ 210.5 Sender's agreement; recovery by Reserve Bank.

(a) * * *

(1) Authorizes the sender's Administrative Reserve Bank and any other Reserve Bank or collecting bank to which the item is sent to handle the item (and authorizes any Reserve Bank that handles settlement for the item to make accounting entries), subject to this subpart and to the Reserve Banks' operating circulars, and warrants its authority to give this authorization;

* * * * *

(c) *Methods of recovery.* (1) The Reserve Bank may recover the amount stated in paragraph (b) of this section by charging any account on its books that is maintained or used by the sender (or by charging a Reserve Bank sender), if—

- (i) The Reserve Bank made reasonable written demand on the sender to assume defense of the action or proceeding; and
- (ii) The sender has not made any other arrangement for payment that is acceptable to the Reserve Bank.

(2) The Reserve Bank is not responsible for defending the action or proceeding before using this method of recovery. A Reserve Bank that has been charged under this paragraph (c) may recover from its sender in the manner and under the circumstances set forth in this paragraph (c). A Reserve Bank's failure to avail itself of the remedy provided in this paragraph (c) does not prejudice its enforcement in any other manner of the indemnity agreement referred to in paragraph (a)(3) of this section.

(d) *Security interest.* When a sender sends an item to a Reserve Bank, the sender and any prior collecting bank grant to the sender's Administrative Reserve Bank a security interest in all of their respective assets in the possession of, or held for the account of, any Reserve Bank to secure their respective obligations due or to become due to the Administrative Reserve Bank under this subpart or subpart C of part 229 of this chapter (Regulation CC). * * *

6. In § 210.6, paragraphs (a)(1) and (b) are revised to read as follows:

§ 210.6 Status, warranties, and liability of Reserve Bank.

(a)(1) *Status and Liability.* A Reserve Bank that handles an item shall act as agent or subagent of the owner with respect to the item. This agency terminates when a Reserve Bank receives final payment for the item in actually and finally collected funds, a Reserve Bank makes the proceeds available for use by the sender, and the time for commencing all actions against the Reserve Bank has expired. A Reserve Bank shall not have or assume any liability with respect to an item or its proceeds except—

(i) For the Reserve Bank's own lack of good faith or failure to exercise ordinary care;

(ii) As provided in paragraph (b) of this section; and

(iii) As provided in subpart C of part 229 (Regulation CC) of this chapter.

* * * * *

(b) *Warranties and liability.* (1) By presenting or sending an item, a Reserve Bank warrants to a subsequent collecting bank and to the paying bank and any other payor—

(i) That the Reserve Bank is a person entitled to enforce the item (or is authorized to obtain payment of the item on behalf of a person who is either entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item); and

(ii) That the item has not been altered.

(2) The Reserve Bank also makes the warranties set forth in § 229.34(c) of this chapter, subject to the terms of part 229 of this chapter (Regulation CC). The Reserve Bank shall not have or assume any other liability to the paying bank or other payor, except for the Reserve Bank's own lack of good faith or failure to exercise ordinary care.

* * * * *

7. In § 210.7, paragraph (c) introductory text and paragraph (d) are revised to read as follows:

§ 210.7 Presenting items for payment.

* * * * *

(c) *Presenting or sending direct.* A Reserve Bank or subsequent collecting bank may, with respect to an item that may be sent to the paying bank or nonbank payor in the Reserve Bank's District—

* * * * *

(d) *Item sent to another district.* A Reserve Bank receiving an item that may be sent to a paying bank or nonbank payor in another District ordinarily sends the item to the Reserve Bank of the other District, but with the agreement of the other Reserve Bank,

may present or send the item as if it were sent to a paying bank or nonbank payor in its own District.

8. Section 210.8 is revised to read as follows:

§ 210.8 Presenting noncash items for acceptance.

(a) A Reserve Bank or a subsequent collecting bank may, if instructed by the sender, present a noncash item for acceptance in any manner authorized by law if—

(1) The item provides that it must be presented for acceptance;

(2) The item may be presented elsewhere than at the residence or place of business of the payor; or

(3) The date of payment of the item depends on presentment for acceptance.

(b) Documents accompanying a noncash item shall not be delivered to the payor upon acceptance of the item unless the sender specifically authorizes delivery. A Reserve Bank shall not have or assume any other obligation to present or to send for presentment for acceptance any noncash item.

9. Section 210.9 is amended by redesignating paragraphs (a) through (e) as paragraphs (b) through (f); adding a new paragraph (a); revising newly redesignated paragraphs (b) and (c); and in newly redesignated paragraph (f) removing the references "paragraphs (a), (b), and (c)" and adding in their place "paragraphs (b), (c), and (d)".

§ 210.9 Settlement and payment.

(a) *Settlement through Administrative Reserve Bank.* A paying bank shall settle for an item under this subpart with its Administrative Reserve Bank, whether or not the paying bank received the item from that Reserve Bank. A paying bank's settlement with its Administrative Reserve Bank is deemed to be settlement with the Reserve Bank from which the paying bank received the item. A paying bank may settle for an item using any account on a Reserve Bank's books by agreement with its Administrative Reserve Bank, any other Reserve Bank holding the settlement account, and the account-holder. The paying bank remains responsible for settlement if the Reserve Bank holding the settlement account does not, for any reason, obtain settlement in that account.

(b) *Cash items—(1) Settlement obligation.* On the day a paying bank receives² a cash item from a Reserve Bank, it shall settle for the item such

² A paying bank is deemed to receive a cash item on its next banking day if it receives the item—

(1) On a day other than a banking day for it; or

(2) On a banking day for it, but after a "cut-off hour" established by it in accordance with state law.

that the proceeds of the settlement are available to its Administrative Reserve Bank by the close of Fedwire on that day, or it shall return the item by the later of the close of its banking day or the close of Fedwire. If the paying bank fails to settle for or return a cash item in accordance with this paragraph (b)(1), it is accountable for the amount of the item as of the close of its banking day or the close of Fedwire on the day it receives the item, whichever is earlier.

(2) *Time of settlement.* (i) On the day a paying bank receives a cash item from a Reserve Bank, it shall settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank, or return the item, by the latest of—

(A) The next clock hour that is at least one hour after the paying bank receives the item;

(B) 9:30 a.m. Eastern Time; or

(C) Such later time as provided in the Reserve Banks' operating circulars.

(ii) If the paying bank fails to settle for or return a cash item in accordance with paragraph (b)(2)(i) of this section, it shall be subject to any applicable overdraft charges. Settlement under paragraph (b)(2)(i) of this section satisfies the settlement requirements of paragraph (b)(1) of this section.

(3) *Paying bank closes voluntarily.* (i) If a paying bank closes voluntarily so that it does not receive a cash item on a day that is a banking day for a Reserve Bank, and the Reserve Bank makes the cash item available to the paying bank on that day, the paying bank shall either—

(A) On that day, settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank, or return the item, by the latest of the next clock hour that is at least one hour after it ordinarily would have received the item, 9:30 a.m. Eastern Time, or such later time as provided in the Reserve Banks' operating circulars; or

(B) On the next day that is a banking day for both the paying bank and the Reserve Bank, settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank by 9:30 a.m. Eastern Time on that day or such later time as provided in the Reserve Banks' operating circulars and compensate the Reserve Bank for the value of the float associated with the item in accordance with procedures provided in the Reserve Bank's operating circular.

(ii) If a paying bank closes voluntarily so that it does not receive a cash item on a day that is a banking day for a Reserve Bank, and the Reserve Bank makes the cash item available to the

paying bank on that day, the paying bank is not considered to have received the item until its next banking day, but it shall be subject to any applicable overdraft charges if it fails to settle for or return the item in accordance with paragraph (b)(3)(i) of this section. The settlement requirements of paragraphs (b)(1) and (b)(2) of this section do not apply to a paying bank that settles in accordance with paragraph (b)(3)(i) of this section.

(4) *Reserve Bank closed.* (i) If a paying bank receives a cash item from a Reserve Bank on a banking day that is not a banking day for the Reserve Bank, the paying bank shall—

(A) Settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank by the close of Fedwire on the Reserve Bank's next banking day, or return the item by midnight of the day it receives the item (if the paying bank fails to settle for or return a cash item in accordance with this paragraph (b)(4)(i)(A), it shall become accountable for the amount of the item as of the close of the its banking day on the day it receives the item); and

(B) Settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank by 9:30 a.m. Eastern Time on the Reserve Bank's next banking day or such later time as provided in the Reserve Bank's operating circular, or return the item by midnight of the day it receives the item. If the paying bank fails to settle for or return a cash item in accordance with this paragraph (b)(4)(i)(B), it shall be subject to any applicable overdraft charges. Settlement under this paragraph (b)(4)(i)(B) satisfies the settlement requirements of paragraph (b)(4)(i)(A) of this section.

(ii) The settlement requirements of paragraphs (b)(1) and (b)(2) of this section do not apply to a paying bank that settles in accordance with paragraph (b)(4)(i) of this section.

(5) *Manner of settlement.* Settlement with a Reserve Bank under paragraphs (b) (1) through (4) of this section shall be made by debit to an account on the Reserve Bank's books, cash, or other form of settlement to which the Reserve Bank agrees, except that the Reserve Bank may, in its discretion, obtain settlement by charging the paying bank's account. A paying bank may not set off against the amount of a settlement under this section the amount of a claim with respect to another cash item, cash letter, or other claim under § 229.34(c) of this chapter (Regulation CC) or other law.

(6) *Notice in lieu of return.* If a cash item is unavailable for return, the

paying bank may send a notice in lieu of return as provided in § 229.30(f) of this chapter (Regulation CC).

(c) *Noncash items.* A Reserve Bank may require the paying or collecting bank to which it has presented or sent a noncash item to pay for the item in cash, but the Reserve Bank may permit payment by a debit to an account maintained or used by the paying or collecting bank on a Reserve Bank's books or by any of the following that is in a form acceptable to the collecting Reserve Bank: bank draft, transfer of funds or bank credit, or any other form of payment authorized by State law.

* * * * *

10. Section 210.10 is revised to read as follows:

§ 210.10 Time schedule and availability of credits for cash items and returned checks.

(a) Each Reserve Bank shall include in its operating circulars a time schedule for each of its offices indicating when the amount of any cash item or returned check received by it is counted as reserves for purposes of part 204 of this chapter (Regulation D) and becomes available for use by the sender or paying or returning bank. The Reserve Bank that holds the settlement account shall give either immediate or deferred credit to a sender, a paying bank, or a returning bank (other than a foreign correspondent) in accordance with the time schedule of the receiving Reserve Bank. A Reserve Bank ordinarily gives credit to a foreign correspondent only when the Reserve Bank receives payment of the item in actually and finally collected funds, but, in its discretion, a Reserve Bank may give immediate or deferred credit in accordance with its time schedule.

(b) Notwithstanding its time schedule, a Reserve Bank may refuse at any time to permit the use of credit given by it for any cash item or returned check, and may defer availability after credit is received by the Reserve Bank for a period of time that is reasonable under the circumstances.

11. In § 210.11, the last sentence of paragraph (b) is revised to read as follows:

§ 210.11 Availability of proceeds of noncash items; time schedule.

* * * * *

(b) * * * A Reserve Bank may, however, refuse at any time to permit the use of credit given by it for a noncash item for which the Reserve Bank has not yet received payment in actually and finally collected funds.

* * * * *

12. Section 210.12 is amended by revising paragraphs (a), (b), and (c)(1),

the first sentence of paragraph (d), paragraphs (f) and (h), and the first sentence of paragraph (i); and by removing the last sentence of paragraph (g), to read as follows:

§ 210.12 Return of cash items and handling of returned checks.

(a) *Return of items—(1) Return of cash items handled by Reserve Banks.* A paying bank that receives a cash item from a Reserve Bank, other than for immediate payment over the counter, and that settles for the item as provided in § 210.9(b) of this subpart, may, before it has finally paid the item, return the item to any Reserve Bank (unless its Administrative Reserve Bank directs it to return the item to a specific Reserve Bank) in accordance with subpart C of part 229 of this chapter (Regulation CC), the Uniform Commercial Code, and the Reserve Banks' operating circulars. A paying bank that receives a cash item from a Reserve Bank also may return the item prior to settlement, in accordance with § 210.9(b) of this subpart and the Reserve Banks' operating circulars. The rules or practices of a clearinghouse through which the item was presented, or a special collection agreement under which the item was presented, may not extend these return times, but may provide for a shorter return time.

(2) *Return of checks not handled by Reserve Banks.* A paying bank that receives a check as defined in § 229.2(k) of this chapter (Regulation CC), other than from a Reserve Bank, and that determines not to pay the check, may send the returned check to any Reserve Bank (unless its Administrative Reserve Bank directs it to send the returned check to a specific Reserve Bank) in accordance with subpart C of part 229 of this chapter (Regulation CC), the Uniform Commercial Code, and the Reserve Banks' operating circulars. A returning bank may send a returned check to any Reserve Bank (unless its Administrative Reserve Bank directs it to send the returned check to a specific Reserve Bank) in accordance with subpart C of part 229 of this chapter (Regulation CC), the Uniform Commercial Code, and the Reserve Banks' operating circulars.

(b) *Handling of returned checks.* (1) The following parties, in the following order, are deemed to have handled a returned check sent to a Reserve Bank under paragraph (a) of this section—

- (i) The paying or returning bank;
- (ii) The paying bank's or returning bank's Administrative Reserve Bank;
- (iii) The Reserve Bank that receives the returned check from the paying or returning bank (if different from the

paying bank's or returning bank's Administrative Reserve Bank); and

(iv) Another Reserve Bank, if any, that receives the returned check from a Reserve Bank.

(2) A Reserve Bank that is not described in paragraph (b)(1) of this section is not a party that handles a returned check and is not a returning bank with respect to a returned check.

(3) The identity and order of the parties under paragraph (b)(1) of this section determine the relationships and the rights and liabilities of the parties under this subpart, part 229 of this chapter (Regulation CC), and the Uniform Commercial Code.

(c) *Paying bank's and returning bank's agreement.* * * *

(1) Authorizes the paying or returning bank's Administrative Reserve Bank, and any other Reserve Bank or returning bank to which the returned check is sent, to handle the returned check (and authorizes any Reserve Bank that handles settlement for the returned check to make accounting entries) subject to this subpart and to the Reserve Banks' operating circulars;

* * * * *

(d) *Warranties by Reserve Bank.* By handling a returned check under this subpart, a Reserve Bank makes the returning bank warranties as set forth in § 229.34 of this chapter, subject to the terms of part 229 of this chapter (Regulation CC). * * *

* * * * *

(f) *Methods of recovery.* (1) The Reserve Bank may recover the amount stated in paragraph (d) of this section by charging any account on its books that is maintained or used by the paying or returning bank (or by charging another returning Reserve Bank), if—

(i) The Reserve Bank made seasonable written demand on the paying or returning bank to assume defense of the action or proceeding; and

(ii) The paying or returning bank has not made any other arrangement for payment that is acceptable to the Reserve Bank.

(2) The Reserve Bank is not responsible for defending the action or proceeding before using this method of recovery. A Reserve Bank that has been charged under this paragraph may recover from the paying or returning bank in the manner and under the circumstances set forth in this paragraph. A Reserve Bank's failure to avail itself of the remedy provided in this paragraph does not prejudice its enforcement in any other manner of the indemnity agreement referred to in paragraph (c)(3) of this section.

* * * * *

(h) *Settlement.* A subsequent returning bank or depository bank shall settle with its Administrative Reserve Bank for returned checks in the same manner and by the same time as for cash items presented for payment under this subpart. Settlement with its Administrative Reserve Bank is deemed to be settlement with the Reserve Bank from which the returning bank or depository bank received the item.

(i) *Security interest.* When a paying or returning bank sends a returned check to a Reserve Bank, the paying bank, returning bank, and any prior returning bank grant to the paying bank's or returning bank's Administrative Reserve Bank a security interest in all of their respective assets in the possession of, or held for the account of, any Reserve Bank, to secure their respective obligations due or to become due to the Administrative Reserve Bank under this subpart or subpart C of part 229 of this chapter (Regulation CC). * * *

By order of the Board of Governors of the Federal Reserve System, May 14, 1997.

William W. Wiles,

Secretary of the Board.

[FR Doc. 97-13028 Filed 5-19-97; 8:45 am]

BILLING CODE 6210-01-P