

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8563]
April 27, 1979

REGULATION J

Comment Invited on Issues Involved in Handling
Checklike Payment Instruments Drawn on Savings Institutions

To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board today [April 23] requested public comment on possible changes in Federal Reserve handling in its check collection system of checklike payment instruments drawn on savings accounts at mutual savings banks and savings and loan associations.

The Board requested comment on the issues it presented by June 1, 1979.

The checklike instruments concerned are:

1. Noninterest-bearing negotiable orders of withdrawal (known as NINOWs) that the State of Pennsylvania has authorized to be drawn on mutual savings banks in that State.
2. Other similar payment instruments, including Payment Orders of Withdrawal proposed by the Federal Home Loan Bank Board to be drawn on savings and loan associations.

The general question on which the Board seeks the advice of the public is: whether the Federal Reserve check collection system can appropriately handle new payments instruments, whose legal characteristics vary from those of traditional checks, as though they were checks.

The problems involved, and further questions on which the Board seeks advice are, in summary:

1. *NINOWs*

Regulations of the Pennsylvania Secretary of Banking issued in 1977 permit mutual savings banks chartered by Pennsylvania to offer their customers special noninterest-bearing savings accounts against which checklike payment instruments (NINOWs) can be written.

These have certain characteristics of checks—i.e., they may be offered, say, to a grocery store for goods or may be cashed and may be endorsed to other recipients. However, they must bear on their face a legend stating that the mutual savings bank on which they are drawn reserves the right to delay payment for at least 14 days. Subsequently, the Pennsylvania Supreme Court ruled that, because of this required legend, a NINOW is not payable upon demand and thus is not a check as defined by the Uniform Commercial Code.

The Pennsylvania court decision placed NINOWs outside the definition of "cash item" in the Board's Regulation J, which regulates the Federal Reserve's payments system activities, including check collection. Regulation J defines a cash item as a "check . . . or other item payable upon demand. . . ."

The Federal Reserve Board has been handling NINOWs as cash items since their inception. The Board has been asked whether, in view of the Pennsylvania Supreme Court decision, it will continue to do so. A formal decision to do so would require amendment of Regulation J.

In requesting comment on continued handling of NINOWs, the Board said:

. . . the Board wishes to know what possible future difficulties banks might experience if NINOWs gain wide acceptance. It is recognized that a significant number of customers of mutual savings banks and others could be inconvenienced if NINOW instruments were less readily available in the marketplace because they could no longer be collected through the Federal Reserve. The Board is concerned about the potential impact that a failure to amend Regulation J ultimately would have on consumers using NINOW instruments . . .

Consequently, the Board requests public comment upon the advisability of continuing to handle payment instruments that are not payable upon demand, such as the NINOW, as though they were checks. In particular, the Board would like to have information arising from the two-year experience in Pennsylvania in the issuing and handling of NINOWs. For example, the Board wishes to know if commercial banks have experienced any

difficulties in handling NINOWs deposited with them, and if they anticipate any future problems. Also, comment is requested on the reception consumers and others have given NINOWs and how widespread their use has been. The Board is thus interested in determining what public benefits would accrue if the Board amended Regulation J to permit the continued handling of NINOWs as cash items.

2. Savings and Loan Payment Orders and Other Such Instruments

In November 1978, the Federal Home Loan Bank Board asked for public comment on a proposal to permit savings and loan associations under its jurisdiction to establish special savings accounts against which their customers could write checklike Payment Orders of Withdrawal. The proposed Payment Orders would be nontransferable and nonnegotiable. Payment Orders would be payable upon demand.

The problem that Payment Orders and other such nontransferable instruments present is that an instrument for making third-party payments that is not transferable raises many significant questions as to the rights and liabilities of subsequent holders of such an instrument, including Federal Reserve Banks. Questions also arise as to what limits must be imposed on the use of such instruments. For example, these instruments may have to be deposited in a financial institution by the recipient, and thus could not be endorsed over to another party by the recipient. Therefore, it is possible that they could be transferred only by financial institutions within the check collection system. The Board requests comment on the possible consumer benefits to users of Payment Orders, as well as on the legal questions posed by the proposed Payment Orders.

The Board stated that it seems likely that increasing numbers and varieties of "hybrid" payment instruments combining some aspects of checks with noncheck characteristics will be offered to the public. The Board would like to have comment on the broad question of how far the Federal Reserve might appropriately go in accepting and presenting for payment such "hybrid" payment instruments.

Printed below is the text of the Board's official notice requesting comments on these issues. Comments should be submitted by June 1 and may be sent to our Check Processing Function.

PAUL A. VOLCKER,
President.

FEDERAL RESERVE SYSTEM
REQUEST FOR COMMENTS ON FEDERAL RESERVE HANDLING
OF NONINTEREST BEARING NEGOTIABLE ORDERS OF WITHDRAWAL (NINOWs)
AND OTHER "CHECK-LIKE" PAYMENT INSTRUMENTS

[Docket No. R-0220]

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comments on Federal Reserve handling of noninterest bearing negotiable orders of withdrawal (NINOWs) and other "check-like" payment instruments.

SUMMARY STATEMENT: The Board of Governors is considering two questions involving the handling of new "check-like" payments instruments in the Federal Reserve's check collection process. These questions are: (1) should Federal Reserve Banks continue to collect, as cash items, noninterest bearing negotiable orders of withdrawal ("NINOWs"), and (2) what other types of payments instruments should be handled by the Federal Reserve's collection system. These questions address the same policy issues concerning the appropriateness of the System's handling, as cash items, increasing numbers and varieties of hybrid "check-like" payments instruments whose legal characteristics vary from those of traditional checks. The Board has invited public comment on these questions by June 1, 1979.

DATE: Comments must be received on or before June 1, 1979.

ADDRESS: Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All material submitted should refer to docket number R-0220.

FOR FURTHER INFORMATION CONTACT: Allen L. Raiken, Associate General Counsel ((202) 452-3625); or Lee S. Adams, Senior Attorney ((202) 452-3594), Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: The Board of Governors is reviewing the current practice of the Federal Reserve System to collect, as cash items, noninterest-bearing negotiable orders of withdrawal ("NINOWs") payment instruments that are drawn on mutual savings banks in the State of Pennsylvania. This review has been made necessary because the Supreme Court of Pennsylvania in 1978 ruled that NINOWs in their present form are not payable on demand and hence are not checks within the Uniform Commercial Code definition (*Pennsylvania Bankers Association v. Secretary of Banking*, (October 5, 1978)).

Because the Board's definition of cash items in Regulation J (12 CFR 210.2(i)(2)) requires that cash items

be checks or other items payable on demand, this definition, unless amended, would not permit Reserve Banks to continue to handle NINOW instruments as cash items. Before reaching a decision on whether or not to amend Regulation J, the Board believes that it will be helpful to receive comments from interested parties on whether such an amendment, which would permit the continued handling of NINOWs by the Federal Reserve System, would be in the public interest and consistent with the Federal Reserve's responsibilities for ensuring an efficient payments system.

Reserve Banks have been handling NINOW instruments as cash items since regulations were issued in 1977 by the Pennsylvania Secretary of Banking that permitted State-chartered mutual savings banks to offer NINOWs to their depositors. That State's regulations require that NINOW instruments bear on their face a legend stating that the mutual savings bank reserves the right to require not less than 14 days' prior withdrawal notice before paying the instrument. In determining that the Secretary of Banking had authority to issue this regulation, the Supreme Court of Pennsylvania recently stated that because of this legend, a NINOW "is obviously not 'payable on demand' and hence not a check within the Uniform Commercial Code definition." Under commercial law, therefore, NINOWs would be considered time drafts rather than demand drafts.

The Board has been requested to consider whether Reserve Banks should continue handling these instruments as cash items. If it is determined that NINOW instruments should be collected through Federal Reserve facilities, Regulation J must be amended. Such an amendment could provide that a Federal Reserve Bank is authorized to accord cash item treatment to any payment instrument that is determined to have characteristics consistent with treatment as a cash item.

Such an amendment raises broad issues concerning the types of payments instruments which should be handled by the Federal Reserve's payments collection system. It is likely that, in the future, additional variations of traditional checks and drafts will be made available to the public, and thus it is expected that questions also will be raised whether the Federal Reserve System's "cash item" collection mechanism should accommodate these instruments. For example, the Federal Home Loan Bank Board has proposed, 43 Federal Register 52254 (November 9, 1978), to allow Federal savings and loan associations to permit customers to issue nonnegotiable, nontransferable orders for payment. A payment instrument is "negotiable" if it provides "holder in due course" status upon transfer, and "transferability" refers to the assignment of rights in the instrument. While an amendment to Regulation J would be necessary to permit handling of NINOW drafts, such an amendment may not be required to permit the handling of the proposed savings and loan payment order provided such instruments are payable on demand.

The permissibility and appropriateness of such items being handled through the Federal Reserve System have already been the subject of discussion between the staffs of the two agencies. While an amendment to Regulation J to permit handling of NINOW drafts would not necessarily address the Federal Home Loan Bank Board proposal, since no amendment may be required, the Board wishes guidance on the extent to which the cash

item definition in Regulation J should be amended or the Board's present policies should be broadened to permit handling of new payments instruments, some of which may be nonnegotiable or nontransferable.

The Board is cognizant of the problems of setting appropriate definitional parameters if Regulation J were changed to permit cash item handling of NINOWs or if payment orders were accorded cash item treatment. Thus the Board would appreciate comment on the scope of change desirable and the most logical point to draw the distinction between cash and noncash collection items.

The Board is also aware that NINOWs have obtained general public acceptance in Pennsylvania and the Federal Reserve System has not experienced any difficulties in providing its collection facilities for these instruments. The Board solicits comment from commercial banks whether they have experienced any difficulties in collecting NINOWs deposited with them, and, if so, what is the nature of these difficulties. In addition, the Board wishes to know what possible future difficulties commercial banks might experience if NINOWs gain wide acceptance. It is recognized that a significant number of customers of mutual savings banks and others could be inconvenienced if NINOW instruments were less readily acceptable in the marketplace because they could no longer be collected through the Federal Reserve. The Board is concerned about the potential impact that a failure to amend Regulation J ultimately would have on consumers using NINOW instruments in Pennsylvania and therefore solicits comment on the public benefits that would occur if such an amendment were adopted to permit continued collection of these instruments. Comment is requested on the acceptance by the public of NINOWs for the payment of goods or services, and on the number of individuals who are using NINOWs as payment instruments.

The Board notes that NOW instruments authorized by Federal law, which are also subject to a notice of withdrawal, do not require any legend. Further, the legend itself may not be fully informative since in offering these instruments a mutual savings bank whose deposits are insured by the Federal Deposit Insurance Corporation must provide for a 30-day notice of withdrawal period, which is a greater restriction than the 14-day period required for NINOWs by State law and reflected in the legend on the instrument. Comment is requested on the consumer protection value that the notice of withdrawal legend serves. In addition, the Board solicits comment on the costs, if any, that would be experienced by financial institutions both in competition and risk exposure by the Federal Reserve continuing to handle these instruments as cash items. Commenters may also wish to address the likelihood of State action to remove the legend requirements and thus make unnecessary further Board consideration of an amendment to the cash item definition in Regulation J.

To aid the Board in its consideration of this matter, interested persons are invited to submit comments, views, or arguments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received not later than June 1, 1979. Such material will be made available for inspection and copying upon request except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information.