

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **10,050**
June 23, 1986]

**REDUCTION OF CHECK AND ACH FLOAT AND
STANDARD HOLIDAY SCHEDULE FOR RESERVE BANKS**

**— Amendments to Regulation J
— Modifications of Federal Reserve Bank Services**

*To All Depository Institutions, 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 has adopted amendments to its Regulation J — Check Collection and Transfers of Funds — concerning the reduction and reallocation of check float and the collection of foreign checks as well as some technical changes. In addition, the Board modified its automated clearing house (ACH) procedures and adopted a standard holiday schedule for Reserve Banks.

One amendment to Regulation J, effective January 1, 1987, requires paying banks that voluntarily close on nonstandard holidays to pay for checks made available to them on those days, or the paying banks may elect to pay the Reserve Bank for the value of the float that occurs.

Other changes to the Regulation permit Reserve Banks to collect checks drawn on banks located in foreign countries. This service will be provided on a limited basis. The technical changes relate primarily to a Reserve Bank's liabilities regarding check collection and wire transfers of funds.

To reduce and reallocate ACH float generated from nonstandard holidays, the Board adopted modifications to Reserve Bank automated clearing house procedures, effective April 1, 1987. In addition, the Board approved a standard holiday schedule for the Reserve Banks to follow. Effective January 1, 1987, all Reserve Banks will be closed on standard holidays — the 10 national holidays.

Enclosed is a copy of the text of the amendments to Regulation J, and of the Board's rules on ACH float recovery procedures and on the standard Reserve Bank holiday schedule. Questions regarding check matters may be directed to John F. Sobala, Assistant Vice President (Tel. No. 212-791-5997); questions regarding ACH and wire transfer of funds matters may be directed to Andrew Heikaus, Manager, Funds Transfer Department, (Tel. No. 212-791-5661).

E. GERALD CORRIGAN,
President.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

COLLECTION OF CHECKS AND OTHER ITEMS
AND WIRE TRANSFERS OF FUNDS

AMENDMENTS TO REGULATION J

MODIFICATIONS OF FEDERAL RESERVE BANK SERVICES

(various effective dates)

FEDERAL RESERVE SYSTEM

12 CFR Part 210

[Docket Nos. 0544, R-0552, and R-0558]

**Collection of Checks and Other Items
and Wire Transfers of Funds;
Regulation J**

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has adopted nine amendments to Regulation J. These amendments will:

(1) Permit the owner of a check or other item who is allegedly injured by a Reserve Bank's alleged failure to exercise ordinary care or act in good faith in collecting an item to bring an action against the Reserve Bank, regardless of whether that person is a "sender" as defined in Regulation J;

(2) Establish, beginning on January 1, 1990, a two-year limitation period for actions against a Reserve Bank for alleged mishandling of items under subpart A or wire transfer items or requests under subpart B, and, beginning August 1, 1986, a two-year limitation period for actions against paying banks for failure to comply with the

notification of nonpayment requirements of subpart A;

(3) Permit Reserve Banks to require any prior indorser to defend a breach of indorsement warranty suit even if the Reserve Bank has not been sued directly;

(4) Authorize Reserve Banks to collect instruments drawn on payors located in foreign countries;

(5) Clarify that Reserve Banks are not liable for consequential damages in handling wire transfers of funds;

(6) Add the Commonwealth of the Northern Mariana Islands to the Twelfth District for collection purposes;

(7) Adopt the definitions of the Uniform Commercial Code for terms that are used but not defined in Regulation J;

(8) Effective January 1, 1987, require paying banks that close voluntarily on days that are banking days for their Reserve Banks to pay on such days for cash items that Reserve Banks make available to them on such days;

(9) Make permanent in slightly modified form the temporary amendment adopted on October 3, 1985, creating a standard holiday schedule to be applied to Regulation J's notification of nonpayment provision.

Items 1 through 7 were proposed for comments on March 22, 1985, 50 FR 12310 (Mar. 28, 1985); item 8 was proposed on November 18, 1985, 50 FR 47772 (Nov. 20, 1985); and item 9's temporary rule became effective on October 3, 1985, 50 FR 41335 (Oct. 10, 1985).

EFFECTIVE DATES: The amendments are effective on the following dates.

January 1, 1987: § 210.9(a)

January 1, 1990: §§ 210.6(c) and 210.38(b)(2)

All other amendments take effect on August 1, 1986.

The amended rules will apply to checks and other items (for amendments to subpart A) or transfer items or requests (for amendments to subpart B) received by a Reserve Bank on or after the applicable effective date.

FOR FURTHER INFORMATION CONTACT:

Earl G. Hamilton, Assistant Director, Division of Federal Reserve Bank Operations (202/452-3879); Joseph R. Alexander, Attorney, Legal Division (202/452-2489); or Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf (TDD) (202/452-3544).

For this Regulation to be complete, retain:

- 1) Regulation J pamphlet, effective August 12, 1981.
- 2) Amendments, effective April 2, 1984 and October 1, 1985 (included in slip sheet dated April 1985).
- 3) This slip sheet.

PRINTED IN NEW YORK, FROM FEDERAL REGISTER, VOL. 51, NOS. 113 AND 115

SUPPLEMENTARY INFORMATION:

1. Reserve Bank Liability To Remote Parties

Section 210.6(a) of Regulation J presently provides that in collecting items a Reserve Bank acts only as the agent of its sender (i.e., the depository institution that forwards an item to a Reserve Bank for collection) and is not an agent for any other party in the transaction. This rule is referred to as the "sender rule". Because the liability of a collecting bank, such as a Reserve Bank, is predicated upon its status as agent, this provision has the effect of insulating a Reserve Bank from liability in collection cases from all parties except the sender. Accordingly, a third party that does not immediately precede a Reserve Bank in the collection process cannot bring an action against the Reserve Bank, even if it is able to demonstrate that it has been injured by the Reserve Bank's failure to exercise ordinary care in handling an item. This provision has been upheld by several courts. See, e.g., *Childs v. Federal Reserve Bank*, 719 F.2d 812 (5th Cir. 1983).

Under section 4-201(a) of the Uniform Commercial Code ("U.C.C."), a collecting bank other than a Reserve Bank is an agent or subagent of the owner of an item. Accordingly, the collecting bank may be held liable to parties other than the immediately preceding party if its improper handling of an item causes them harm.

The sender rule dates from the 1920s, before the state laws on check collection were standardized. At that time, the sender rule was in effect in a number of states, and the U.S. Supreme Court had previously approved the sender rule in cases where federal law was to be applied. See, *Exchange National Bank v. Third National Bank*, 112 U.S. 276 (1884); see also, *Federal Reserve Bank v. Malloy*, 264 U.S. 160, 164 (1924). The U.C.C., however, adopted a different rule, and it is the U.C.C. rule that is now almost universal.

The Board proposed to amend Regulation J to delete the sender rule so that Reserve Banks are subject to suit by the same parties that may bring actions against collecting banks, and to make it clear that warranties made by collecting banks and other prior parties under state law run to Reserve Banks as well as other collecting banks. All of the commenters supported the Board's proposal, and the Board has adopted the amendment as proposed.

2. Limitation Period

a. Action Against a Reserve Bank

Regulation J is silent as to the time limits in which a person may bring

action against a Reserve Bank for mishandling checks or other items (in subpart A) and wire transfer items or requests (in subpart B). Consequently, courts may apply state law. This has resulted in a lack of uniform treatment among Reserve Banks, since applicable laws vary from state to state,¹ and it is often unclear even within a state which limitation period applies. See *Bank of America N.T. & S.A. v. Security Pacific National Bank*, 23 Cal. App. 3d 638, 100 Cal. Rep. 438 (1972); *First State Bank v. Tanner*, 495 S.W.2d 267 (Tex. Civ. App. 1973). Given the identical functions performed by Reserve Banks and their offices in collecting checks and handling wire transfers, the Board proposed to establish a uniform two-year limitation period for the commencement of actions against Reserve Banks for mishandling check collections and wire transfers.

Forty-one commenters responded to this proposal: 18 of them (44 percent) supported it; 23 (56 percent) opposed it. Opposing commenters based their opposition largely on their belief that this proposal represents an abuse of the Federal Reserve's regulatory authority by creating an advantage for Reserve Banks which is not enjoyed by their private sector counterparts. Opposing commenters pointed out that private sector collecting banks would not receive any benefit from this rule, and would still be subject to liability for up to six years. Nevertheless, most of the commenters, even those opposed to this proposal, supported the concept of a uniform statute of limitations for all depository institutions involved in check collection and wire transfer cases. This is especially important in light of the increasing importance of interstate banking.

This proposal, like all the proposals the Board is here adopting, was not intended to give a competitive advantage for Federal Reserve Banks vis-a-vis private sector institutions. Rather, the Board believes that the present state of the law, as regards both Reserve Banks and private sector institutions, is unsatisfactory. While the Uniform Commercial Code has standardized the responsibilities and

¹ While state statutes of limitations sometimes provide for specific limitations periods arising out of specific kinds of actions (see e.g., Cal. Civ. Pro. Code § 340.5 (West 1982), which provides that, with certain exceptions, an action for professional negligence against a health care provider must be commenced within the shorter of three years after the date of the injury, or one year after the plaintiff either discovers the injury or should have discovered it through the use of reasonable diligence), such statutes generally do not address actions arising out of the collection of checks or the transferring of funds by wire. Rather, such actions are covered by more general statutes.

liability of collecting banks throughout the nation, there has as yet been no attempt to standardize the time for which institutions may be held liable for mishandling checks. Thus, a collecting bank in Massachusetts may be held liable for three years, while one in Illinois is held liable for five years and one in California is held liable for four years,² even though the plaintiffs' actions against them may arise from exactly the same kinds of actions.

This problem will intensify as interstate banking becomes more of a reality, and it could result in inefficiencies in the check clearing process if banks shift their clearing operations to states with the most favorable laws. The Board believes that collecting banks, whether they are Reserve Banks or private sector correspondents, perform nearly identical functions regardless of where they are located, and should not be subject to differing periods of liability merely because of their location.

If a Reserve Bank does mishandle a check or wire transfer, the results of the mishandling should be apparent almost immediately. Requiring the injured party to sue within two years after the injury occurs does not appear to impose any significant hardship on any affected parties. A two-year period provides an adequate time for the institution involved to identify the problem, and if it cannot be resolved through discussions with its Reserve Bank, to bring an appropriate action against the Reserve Bank. The Board further believes that establishment of a two-year limitation on actions against Reserve Banks may serve as a model to encourage state legislatures to enact similar limitation periods.

In order to address the issues of comparability between Reserve Banks and collecting banks, one commenter suggested that the Board delay the effectiveness of this amendment until January 1, 1988, to give the states time to adopt similar legislation. The Board believes that this is a useful approach—it allows the Federal Reserve to encourage an improvement in payments law, while at the same time avoiding the appearance of the Federal Reserve's abusing its regulatory authority for competitive gain that some may see in this action. The Board believes, however, that a January, 1988, effective date would not give the states sufficient time to act, given the usual time for changes in uniform laws, and, therefore,

² See, Mass. Gen. Laws Ann. ch. 20, § 2A (West Supp. 1984); Ill. Stat. Ann. ch. 110, § 13-205 (Smith-Hurd 1982); Cal. Civ. Proc. Code § 343 (West 1982).

the Board is delaying the effective date of this amendment until January 1, 1990.

Accordingly, the Board has determined to adopt a two-year limitation, period for actions against a Reserve Bank for alleged mishandling of items under subpart A or wire transfer items or requests under subpart B. This amendment will take effect on January 1, 1990.

b. Action Against a Paying Bank for Failure To Give Notice of Nonpayment

In February, 1985, the Board adopted an amendment to Regulation J requiring paying banks to provide notice to depository banks when they return unpaid large-dollar items presented by Reserve Banks. This amendment took effect on October 1, 1985. In responding to the Board's proposal, one commenter asked what statute of limitations applied to the depository bank's claim against the paying bank for failure to comply with the notification requirement. As is the case with actions against a Reserve Bank, the limitations period of the state in which the paying bank is located would ordinarily be applied.

The Board sought comment on whether it would be appropriate to establish a two-year limitation period applicable to actions against a paying bank for failing to make the required notice of nonpayment. In the absence of such a rule, the application of different state limitation statutes could result in a paying bank in one state being in jeopardy for a longer period than a paying bank in another state even though both would be alleged to have violated a uniform requirement of a federal regulation in exactly the same way.

The commenters overwhelmingly supported the proposal. Of the 32 respondents commenting on this issue, 26 (81 percent) supported it.

Those commenters opposing the proposal generally believed that the limitation period for the notice of nonpayment requirement should be consistent with the limitation period for actions against Reserve Banks, and that both should be consistent with state law.

The Board believes the notification requirement should be applied uniformly, and that it should not work in conjunction with varying state laws to subject some persons to liability longer than others. Accordingly, the Board has adopted the proposed amendment.

3. Tender of Defense

Section 210.5 of Regulation J establishes a procedure that allows a Reserve Bank, when sued by a

subsequent collecting or paying bank, to demand that the sender undertake defense of the action. This "tender of defense" provision simplifies forged indorsement cases by requiring the party that should have obtained a proper indorsement to come into the action and defend.³ This provision, however, applies only when the action has been brought directly against a Reserve Bank. Litigation may be reduced by eliminating the requirement that an action must be brought against a Reserve Bank before defense is tendered by a Reserve Bank to a prior party. Accordingly, the Board sought comment on a proposed amendment that would accomplish this result.

The proposed amendment also incorporated a provision found in the uniform provisions of the Reserve Banks' operating circulars on the collection of cash items that provides that if a Reserve Bank tenders defense of an action to a prior party, the Reserve Bank is not responsible for defending the action.

Thirty-six comments were received on the proposal; 28 (78 percent) of them supported the proposal as eliminating multiple lawsuits. The eight comments opposing the proposal generally thought that Reserve Banks would be given an unfair advantage over private sector banks because of their ability to recover the amount of their liability by charging the sender's account.

The Board believes that the proposal will provide a more efficient way of handling forged indorsement cases. Further, the Board also believes that adoption of the proposal will not result in a significant increased advantage for Reserve Banks over competing private sector banks. The Reserve Banks already have the right to charge back under present procedures; this amendment would merely add a relatively limited class of cases to those instances when the charge-back would be applied under the current regulation. Further, many private sector institutions would be collecting checks only for parties that have accounts with them (e.g. other banks or individuals or corporate depositors), and could exercise a banker's right of set-off to recover amounts that they had been held liable for, thus approximating the Reserve Banks' right to charge back.

³ A similar provision is found in U.C.C. § 3-803. The U.C.C. provision differs from the Regulation J tender provision in that the U.C.C. allows the person tendered defense to require other prior parties to defend the action. The U.C.C. provision also does not clearly permit the person tendering defense to recover the amount of the judgment and expenses of litigation by charging the prior indorser's account.

4. Deposit of Foreign Items

Regulation J defines the term "item" to include only instruments payable within a Federal Reserve District. Federal Reserve Districts include the United States, Puerto Rico, the U.S. Virgin Islands, Guam, and American Samoa.⁴ This definition effectively excludes from the coverage of Regulation J instruments drawn on payors located outside the United States, and consequently Reserve Banks do not collect such instruments. Many smaller institutions have indicated that this restriction imposes substantial hardships on them, because it requires them to maintain a separate relationship with a correspondent bank that would handle foreign items, and because foreign items inadvertently sent to a Reserve Bank are returned by the Reserve Bank, causing undue delay. Consequently, they have requested that Reserve Banks collect such items in order to reduce the operating burden the current limitation imposes.

Accordingly, the Board proposed an amendment to Regulation J that would allow depository institutions to deposit with their Reserve Banks items payable in foreign countries. At the time the Board proposed the amendment, Board and Reserve Bank staffs had not developed a proposal that would add the collection of foreign items to the priced services offered by the Reserve Banks. Thus, the proposed amendment did not specify a particular service arrangement, but would merely clear the regulatory obstacle to the service's implementation.

Forty-seven commenters addressed this proposal. 26 (55 per cent) opposed it, while 21 (45 per cent) supported it.

The negative commenters generally argued that, contrary to the Board's criteria for the introduction of new services; the Federal Reserve had not demonstrated any need for a foreign collection service, and that the Federal Reserve was using foreign collections as a means of gaining market share. Consequently, if the Board adopted the new service it would be abusing its regulatory power in order to advance the Reserve Banks' business interests. Several commenters also said that the Board had not provided sufficient detail in its proposal regarding such issues as operational procedures and prices.

After reviewing the comments, Board and Reserve Bank staffs undertook an effort to define the proposed service further in light of the commenters

⁴ After Board action today, the Northern Mariana Islands also are within a Federal Reserve District.

concerns. The Board believes that a limited service will meet the objections to a more comprehensive Federal Reserve foreign collection service.

Accordingly, the Board has approved the proposed amendment to Regulation J, and is simultaneously adopting a policy applicable to Federal Reserve Banks under which the collection of foreign items will be an incidental service oriented toward existing depositors. Under this policy:

1. Each Reserve Bank will have the option to offer the service, and will determine which foreign items it will collect for its depositors.

2. Foreign items will be accepted only as an incidental service from regular depositors of domestic items. Further, Reserve Banks will not promote this service independently of regular check collection services.

3. Each Reserve Bank offering the service will solicit written proposals from depository institutions interested in collecting foreign items for the Reserve Bank.

The depository institutions should be asked to specify the terms for their service, including per item fees, availability, exchange rates, and other factors deemed important by the Reserve Bank. The Reserve Bank will then select an institution based upon the Reserve Bank's determination of the best combination of terms available among the proposals. No contract with a correspondent institution for foreign collections will be for a period of more than two years, after which time the Reserve Bank will solicit new proposals.

4. Reserve Bank prices will be based on the prices and terms obtained from the solicitation process. A Reserve Bank's price will include the fees paid to the correspondent and the Reserve Bank's full costs for handling the item. The PSAF will be applied to the appropriate Reserve Bank costs; it need not be applied to the correspondent's fees, which already will include the costs (such as taxes and return on capital) imputed with the PSAF.

Because of the limited nature of this new service, the Board does not expect that it will have any significant long-run effects on the nation's payments system, and accordingly it is not necessary under the Board's pricing principles to publish for public comment the prices and service arrangements.

5. Damages for Wire Transfers

Regulation J currently provides that a Reserve Bank may be liable for damages if it fails to exercise ordinary care or act in good faith in handling a wire transfer of funds. Regulation J, however, does not clearly specify that a Reserve Bank is

liable only for direct damages and is not liable for consequential damages.

The Board proposed to amend Regulation J to limit a Reserve Bank's liability for mishandling wire transfer items and requests to damage that is directly and immediately attributable to the mishandling and to make it clear that a Reserve Bank will not be liable for consequential damages.

Of the 38 comments received on this proposal, 25 (66 per cent) supported it, while 13 (34 per cent) were opposed. Those opposing the proposal generally acknowledged that institutions have amended their contracts with customers to avoid liability for consequential damages, but said that contractual arrangements could not provide them with the same level of security that a federal regulation would provide to the Reserve Banks. Therefore, adoption of the amendment would give an advantage to the Reserve Banks that results from the exercise of regulatory authority and not the competitive merits of the Fedwire service.

The Board believes that these objections are not well founded. Even those that opposed this amendment generally acknowledged that the standard that the proposal seeks to achieve for the Reserve Banks is the standard of the industry, and the Board does not believe that it would be appropriate for Reserve Banks to bear a substantially greater risk of liability than the rest of the banking industry.

Although it may be true that a federal regulation would provide more protection to a Reserve Bank than a similar provision in a wire transfer agreement would provide to private sector institutions, the Board does not believe that this is sufficient reason for not going forward with a desirable change to Regulation J. As with the proposal regarding the period during which actions may be commenced against a Reserve Bank for mishandling checks and wire transfers, the Board believes that this concept is a desirable one for the industry as a whole, and, to the extent that institutions transmitting wire transfers on the behalf of customers cannot protect themselves through agreements, state laws should be amended to insulate transmitting banks from liability for consequential damages in the area of wire transfers.⁵

⁵ While the law has not been completely settled on this point, a leading case holds that consequential damages may not be awarded unless the transmitting bank is put on notice of the special circumstances giving rise to them. *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982). The Board, however, does not believe that this is a practical solution. It is not clear what kind of information would have to be available to the

The Board believes that it can best induce these changes by taking the lead and adopting this proposal.

6. Northern Mariana Islands

The San Francisco Reserve Bank had received a request from a bank in the Northern Mariana Islands for a routing number so that collecting banks could automatically process checks drawn on it. Because the Northern Marianas are not now located in any Federal Reserve District for collection purposes, Regulation J would have to be amended. Because of precedent in amendments to Regulation J that redefined the Twelfth District to include Guam and American Samoa, the Board proposed to include the Northern Mariana Islands within the Twelfth District.

There was no opposition to the proposal in the public comments, and the Board has adopted it.

7. Incorporating U.C.C. Definitions

Regulation J defines several terms used in the regulation. For the most part, these definitions define terms that are not found in the U.C.C. (e.g., "paying bank" and "sender") or define terms differently than the U.C.C. does (e.g., "bank"). Other terms, however, are not defined in Regulation J, such as "good faith," "presentment," and "holder." As these terms are used without explicit definition, the Board proposed to amend Regulation J to adopt the terminology of the U.C.C. where it is not inconsistent with the definitions specifically provided in the regulation or where the context does not require a different interpretation.

There was no significant opposition to this proposal in the public comments, and the Board has adopted it.

8. Holiday Schedule for Notice of Nonpayment Provision

In October, 1985, the Board adopted as an interim rule an amendment to Regulation J that defined a holiday schedule for purposes of the requirement that paying institutions give notice of nonpayment for large-dollar checks directly to the depository bank. The holidays adopted by the Board include all Saturdays and Sundays and the ten:

Reserve Bank, or how the Reserve Bank would have to be informed; nor is it clear whether the Reserve Bank would be in a position to evaluate the information that the customer provided. Rather, the Board believes that the customer originating the transfer is in the best position to know of the consequences of a failure to make a timely payment, and that customer should be required to take prudent steps to avoid these consequences and should bear the risks if those steps prove to be inadequate.

holidays observed by the federal government.⁶

One significant issue that was raised by the commenters concerned the treatment of fixed-date holidays (such as July 4) falling on Saturday or Sunday. Under the temporary rule, a holiday falling on a Sunday would be observed on the following Monday, and one falling on a Saturday would be observed on the previous Friday. The commenters agreed with the treatment of holidays falling on Sundays, but several said that usual banking industry practice was not to close on the previous Friday if the holiday falls on a Saturday. They also pointed out that, for example, Friday, December 31, would probably be an important business day for customers, and that it would be useful to get notification of nonpayment on such days.

The Board agrees with these comments, and, in making the temporary rule final, it has amended the rule by deleting the clause that provides that a fixed-date holiday falling on a Saturday will be observed on the previous Friday.⁷

9. Nonstandard Holiday Float

In November, 1985, the Board proposed that Regulation J be modified so that a paying institution electing to close on a voluntary nonstandard holiday would be given the option of accepting the debit for checks that would have been presented to it if it were open for business or paying for the value of the float.⁸ The Board noted that the increasing prevalence of interstate banking created the potential for increases in such float, and that current procedures for deferring credit to senders for nonstandard holiday float are generally limited to those instances where all banks in a state are closed.⁹

⁶ In a related action today, the Board approved a Reserve Bank proposal to adopt a standard holiday schedule beginning in 1987.

⁷ This treatment conforms to the standard Reserve Bank holiday schedule referred to in note 7.

⁸ Daily average nonstandard holiday float in cash item collection services is now approximately \$5 million.

⁹ The Board noted in its original proposal, 50 FR 47,772 (Nov. 20, 1985), that the Delaware State Bank Commissioner permits banks located in that state to close on any day they choose, provided they give the public advanced notice. Banks with affiliates in other states may take advantage of this fact to close on days that their out-of-state affiliates are closed, regardless of whether other banks in Delaware are closed, and regardless of whether the Philadelphia Reserve Bank is observing the holiday. The Board noted that this situation creates the potential for substantial increases in nonstandard holiday float, and that cases like this are likely to increase as interstate banking becomes more prevalent.

Against this background, the Board proposed to require paying banks that voluntarily close on nonstandard holidays to pay for cash items made available to them on such days. If the nonstandard holiday is mandatory, the paying bank would not have to pay for items made available by its Reserve Bank.

Because it is difficult to distinguish between mandatory and voluntary holidays, a preliminary list of proposed mandatory nonstandard holidays was issued as part of the Board's request for public comment. In order to provide sufficient time to identify all mandatory holidays, an implementation date of January 1, 1987, was proposed.

Forty-three of the 45 commenters on this proposal supported it. Two comments opposed this proposal, albeit for different reasons. One commenter suggested that the proposal was unfair to small, rural banks; the other commenter suggested that the problem of interstate banking, which increases the potential for nonstandard holiday float, is unique to Delaware and, as such, the proposal should only apply to institutions in that state.

The Board does not believe that the proposal is unfair to small, rural banks or other institutions. Some institutions may observe more voluntary nonstandard holidays than others, but the Board believes that this is a voluntary decision made by the institutions, and it is reasonable that the institutions be made responsible for the float incurred by their actions. The Board also believes that a national policy to deal with float resulting from the observance of voluntary nonstandard holidays is appropriate given the expansion of interstate banking throughout the United States.

Accordingly, the Board has approved the proposed amendment to Regulation J that will give a paying bank electing to close on a voluntary nonstandard holiday the option of accepting the debit for cash items that would have been presented to it if it had been open for business or of paying for the value of the float.

Regarding the Board's request for comment on a preliminary list of mandatory nonstandard holidays, a number of commenters offered suggestions for changing or adding to the list. Suggestions were made to add Patriot's Day, Seward's Day, Easter Monday, Alaska Day, and the day after Christmas to the list of mandatory nonstandard holidays for various states.

The Board believes that some of the holidays may in fact be mandatory, but that these issues should be resolved

locally. Each Reserve Bank whose District contains states observing mandatory nonstandard holidays should publish as an appendix to its operating circular on the collection of cash items a list of mandatory nonstandard holidays observed in its District.

Regulatory Flexibility Analysis

The Board does not believe that these amendments will have a significant economic impact on a substantial number of small businesses or organizations.

List of Subjects in 12 CFR Part 210

Banks, banking, Federal Reserve System.

PART 210—[AMENDED]

Pursuant to its authority under section 13 of the Federal Reserve Act, 12 U.S.C. 342; section 16 of the Federal Reserve Act, 12 U.S.C. 248(o) and 360; section 11(i) of the Federal Reserve Act, 12 U.S.C. 248(i); section 19(f), 12 U.S.C. 464; and other provisions of law, the Board hereby amends 12 CFR Part 210, Regulation J, as set forth below:

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

Authority: Federal Reserve Act, sec. 13, 12 U.S.C. 342; sec. 11(i), 12 U.S.C. 248(i) sec. 16, 12 U.S.C. 248(o) and 360; and sec. 19(f), 12 U.S.C. 464.

2. By adding a new undesignated paragraph to the end of § 210.2, and by revising footnote 1 to read as follows:

§ 210.2 Definitions.

* * * * *

Unless the context otherwise requires, the terms not defined herein have the meanings set forth in the Uniform Commercial Code.

¹ For purpose of this subpart, the Virgin Islands and Puerto Rico are deemed to be in the Second District, and Guam, American Samoa, and the Northern Mariana Islands in the Twelfth District.

3. In § 210.3, new paragraph (e) is added to read as follows:

§ 210.3 General provisions.

* * * * *

(e) *Foreign items.* A Reserve Bank also may receive and handle certain items payable outside a Federal Reserve District, as provided in its operating circulars. The handling of such items in a state is governed by this subpart, and the handling of such items outside a state is governed by the local law.

4. In § 210.5, paragraphs (a) (2), (b), and (c) are revised to read as follows:

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

(a) * * *
(2) Warrants to each Reserve Bank handling the item that: (i) The sender has good title to the item or is authorized to obtain payment on behalf of one who has good title (whether or not this warranty is evidenced by the sender's express guaranty of prior indorsements on the item); and

(ii) To the extent prescribed by state law applicable to a Reserve Bank or subsequent collecting bank handling the item, the item has not been materially altered; but this subparagraph (a)(2) does not limit any warranty by a sender or other prior party arising under state law; and

(b) *Recovery by Reserve Bank.* If an action or proceeding is brought against (or if defense is tendered to) a Reserve Bank that has handled an item, based on:

(1) The alleged failure of the sender to have the authority to make the warranty and agreement in paragraph (a)(1) of this section;

(2) Any action by the Reserve Bank within the scope of its authority in handling the item; or

(3) Any warranty made by the Reserve Bank under § 210.6(b) of this subpart, the Reserve Bank may, upon entry of a final judgment or decree, recover from the sender the amount of attorneys' fees and other expenses of litigation incurred, as well as any amount the Reserve Bank is required to pay because of the judgment or decree of the tender of defense, together with interest thereon.

(c) *Methods of recovery.* 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 if the sender is another Reserve Bank, by entering a charge against the other Reserve Bank through the Interdistrict Settlement Fund), if:

(1) The Reserve Bank made reasonable written demand on the sender to assume defense of the action or proceeding; and

(2) The sender has not made any other arrangement for payment that is acceptable to the Reserve Bank.

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 through the Interdistrict Settlement Fund may recover from its sender 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 (a)(3) of this section.

5. In § 210.6, paragraph (a)(1) is revised, and, effective January 1, 1990, new paragraph (c) is added as set forth below:

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

(a)(1) *Status and liability.* A Reserve Bank shall act only as agent or subagent of the owner in respect of an item. This agency terminates not later than the time the Reserve Bank receives payment for the item in actually and finally collected funds and makes the proceeds available for use by the sender. A Reserve Bank shall not have or assume any liability in respect of an item or its proceeds except for the Reserve Bank's own lack of good faith or failure to exercise ordinary care and except as provided in paragraph (b) of this section.

(c) *Time for commencing action against Reserve Bank.* A claim against a Reserve Bank for lack of good faith or failure to exercise ordinary care shall be barred unless the action on the claim is commenced within two years after the claim accrues. A claim accrues on the date when a Reserve Bank's alleged failure to exercise ordinary care or to act in good faith first results in damages to the claimant.

6. Effective January 1, 1987, the last sentence of § 210.9(a)(2) is revised to read as follows:

§ 210.9 Payment.

(2) * * * A paying bank that closes voluntarily on a day that is a banking day for the Reserve Bank shall either pay on that day by the close of the Reserve Bank's banking day for cash items that the Reserve Bank makes available to the paying bank on that day, or compensate the Reserve Bank for the value of the float associated with the items in accordance with procedures provided in its Reserve Bank's operating circular; in such circumstances, the paying bank is not considered to receive the item until its next banking day.

7. In § 210.12, paragraph (c)(10) is revised and new paragraph (c)(11) is added as set forth below:

§ 210.12 Return of cash items.

(10) The following days shall not be considered banking days for purposes of the deadline for notice of nonpayment:

Saturdays and Sundays, January 1, the third Monday in January, the third Monday in February, the last Monday in May, July 4, the first Monday in September, the second Monday in October, November 11, the fourth Thursday in November, and December 25. If January 1, July 4, November 11, or December 25 fall on a Sunday, the next following Monday shall not be considered a banking day for purposes of this subsection.

(11) A claim for failure to comply with the requirements of this paragraph (c) is barred unless the action on the claim is commenced within two years after the date upon which the notice was required to be received by the depository bank.

8. In § 210.38, paragraph (b) is revised to read as follows:

§ 210.38 Reserve Bank liability.

(b) *Damages.* A Reserve Bank is liable to its immediate transferor for a failure to credit the amount of a transfer item or request to the transferee's account caused by a Reserve Bank's failure to exercise ordinary care or act in good faith. A Reserve Bank's liability for such a failure to credit is limited to damages that are attributable directly and immediately to the failure to credit, but does not include damages that are attributable to the consequences of the failure to credit, even if such consequences were foreseeable at the time of such failure.

9. Effective January 1, 1990, in § 210.38, paragraph (b) is redesignated paragraph (b)(1), and new paragraph (b)(2) is added as follows:

§ 210.38 Reserve Bank liability.

(2) A claim against a Reserve Bank for failure to exercise ordinary care or to act in good faith shall be barred unless the action on the claim is commenced within two years after the claim accrues. A claim accrues on the date a Reserve Bank's alleged failure to exercise ordinary care or to act in good faith first results in damages to the claimant.

By order of the Board of Governors, June 6, 1986.

William W. Wiles,
Secretary of the Board.

[Docket No. R-0558]

Modifications to Federal Reserve Services

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Modifications to Federal Reserve Bank services.

SUMMARY: The Board has (1) adopted a proposal to modify the procedures used by Federal Reserve Banks to recover the value of float generated in automated clearing house ("ACH") operations due to nonstandard holiday closings, and (2) approved a proposal to establish a standard holiday schedule to be followed by Federal Reserve Banks.

DATE: The modifications to ACH float recovery procedures will take effect on April 1, 1987; the standard Reserve Bank holiday schedule will take effect on January 1, 1987.

FOR FURTHER INFORMATION CONTACT: Florence M. Young, Adviser (202-452-3955) Division of Federal Reserve Bank Operations; Joseph R. Alexander, Attorney, Legal Division (202-452-2489); or Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf (TDD) (202-452-3544).

SUPPLEMENTARY INFORMATION:

Background

For the past several years, the Federal Reserve has made continuous efforts to reduce float in the nation's payments system. As part of these efforts, on November 18, 1985, the Board proposed to reduce float in check and ACH transactions generated as a result of nonstandard holiday closings (state or local holidays not observed on a regional or national basis). 50 FR 47752 (Nov. 20, 1985). At the same time, the Board also proposed to reduce the financial risks to the Federal Reserve by changing procedures for handling ACH credit transactions on days that the originator is closed, and a proposal to establish a standard holiday schedule for the Federal Reserve Banks.

With this action, the Board is adopting in modified form the proposal for the reduction of ACH float and approving the Reserve Banks' proposal for a uniform holiday schedule. In a related action today (Docket No. R-0544), the Board approved the proposal regarding check float. The Board has decided to defer action with respect to reducing ACH risks pending consideration of broader risk issues that were published for comment in May, 1985. Docket No. R-0515B, 50 FR 21135 (May 22, 1985).

ACH Float

In ACH transactions, float may be created if a party to a transaction is closed on the date the transaction is to be settled. In such cases, the Federal Reserve may not be able to debit the appropriate account at the same time that credit is passed.¹ Some of this float is generated as a result of nonstandard holidays (state or local holidays not observed on a regional or national basis).

Currently, the Federal Reserve recovers most ACH float attributed to nonstandard holiday closings through the use of "as of" adjustments made to originators' accounts. Originators are also given the option of paying for the float that results from being closed on the settlement date. These procedures have enabled the Federal Reserve to keep nonstandard holiday float to a daily average of approximately \$2 million.

These procedures, however, place the entire burden of the recovery on originators of ACH transactions. The National Automated Clearing House Association ("NACHA") indicated to the Board that it is often difficult for originators to pass float costs back to their customers, and that the current procedures therefore discourage small- and medium-size institutions from beginning to originate ACH transactions. Accordingly, the Board proposed a change to the procedures for recovering ACH float arising because one of the parties to an ACH debit transaction (originator, receiver, Reserve Bank) is closed.

The Board also proposed a change to the Treatment of ACH credit transactions when one of the parties to the transaction is closed that was designed to minimize the risks to the Federal Reserve System that arise because the Federal Reserve treats ACH credit transactions as final on the settlement date.

Most of the commenters responding to these proposals supported the proposed treatment of ACH debit transactions. Substantial issues were raised, however, with respect to the treatment of ACH credit transactions, with commenters expressing the opinion that the Board

¹ In ACH transactions, credits and debits resulting from the same transaction would normally be posted on the same day. In credit transactions, the originator's account is debited and the receiver's account is credited; these entries are generally treated as final. In a debit transaction, the originator's account is credited and the receiver's account is debited; these entries are treated as provisional.

should not attempt to address these issues in isolation. Rather, the commenters urged the Board to defer action on this proposal pending its consideration of the larger ACH risk issues that were published for comment in May, 1985. See Docket No. R-0515B, 50 FR 21,135 (May 22, 1985). With respect to the proposal for treating ACH debits on nonstandard holidays, approximately 16 percent of the commenters opposed it for various reasons: one felt that the proposal was too complex and would cause reconciliation problems, while another thought that the float burden should be placed on the originator as the only party that can control the generation of ACH transactions.

After analysis of these issues the Board has decided to

1. Defer action on ACH credit transactions pending resolution of the larger issues involving ACH risk, and
2. Adopt in modified form the proposal regarding ACH debit transactions.

Under the modified proposal concerning debit transactions adopted by the Board, if an originator of an ACH debit transaction is closed on a nonstandard holiday, the Reserve Bank will credit the originator's account as though the institution were open. If a receiver of an ACH debit transaction is closed on a nonstandard holiday, the Reserve Bank will debit the receiver's account as though the institution were open or assess the cost of the float through an explicit charge or an as-of adjustment. Nevertheless, if, after consultation with its Reserve Bank, an institution still objects to receiving debits on mandatory nonstandard holidays, the Reserve Bank will not charge the institution on such days, but will use the current procedures for recovering the ACH float that results.

Reserve Bank Holiday Schedule

Several commenters to previous float reduction proposals had recommended that the Federal Reserve should observe a standard holiday schedule. These commenters indicated that a standard holiday schedule would reduce the number of occasions when one Federal Reserve office was open and another closed, and, therefore, would reduce the uncertainty as to whether they would or would not be credited for their deposits. In response to these concerns, the Board proposed to adopt the following uniform holiday schedule for all Reserve Banks beginning in 1987:

All Saturdays,
All Sundays,
New Year's Day (January 1)
Martin Luther King's Birthday (third
Monday in January),
Washington's Birthday (third Monday in
February),
Memorial Day (last Monday in May),
Independence Day (July 4),
Labor Day (first Monday in September),
Columbus Day (second Monday in
October),
Veterans' Day (November 11),
Thanksgiving Day (fourth Thursday in
November), and
Christmas Day (December 25).

It was also proposed that if a fixed
holiday (such as Christmas) falls on a
Saturday, the holiday would be
observed on the previous Friday; if it
falls on a Sunday, the holiday would be

observed on the following Monday.²

All of the 54 comments addressing
this issue supported a standard holiday
schedule for Reserve Banks. The
respondents believed that adoption of
such a schedule by Reserve Banks
would provide substantial economic
benefits to the nation's payments
mechanism by eliminating some of the
uncertainty surrounding the crediting of
cash letters sent to Reserve Banks,
allowing depository institutions to
experience more even workflows, and
providing customers more timely access
to their funds. Several commenters did
suggest that Reserve Banks not close on
the Friday prior to a Saturday holiday,
but instead observe the holiday on that
Saturday or the following Monday.

² This holiday schedule is standard, not uniform.
It will be followed by all offices of the Federal
Reserve Banks with one exception: the Federal
Reserve Bank of Atlanta's New Orleans office will
continue to close on Mardi Gras.

These respondents indicated that most
states do not observe a Saturday
holiday on the prior Friday, and,
therefore, most banks would be required
to remain open under state law. They
also believed that closing Reserve Banks
on Friday would place an unnecessary
hardship on the banking industry and its
customers, saying, for example, that
Friday, December 31, would be a very
important business day for business
customers.

The Board agrees that the banking
industry and the nation's payment
mechanism would be better served by
not observing Saturday holidays on the
preceding Fridays, and has modified the
proposal accordingly.

By order of the Board of Governors of the
Federal Reserve System June 6, 1986.

William W. Wiles,
Secretary of the Board.

[FR Doc. 86-13220 Filed 6-11-86; 8:45 am]

BILLING CODE 6210-01-M