

**FEDERAL RESERVE BANK  
OF NEW YORK**

[ Circular No. **10239** ]  
May 25, 1988 ]

**EXPEDITED FUNDS AVAILABILITY**

**Overview of New Regulation CC  
Effective September 1, 1988**

*To All Depository Institutions, and Others Concerned,  
in the Second Federal Reserve District:*

On May 13, 1988, the Board of Governors of the Federal Reserve System announced the adoption of a new regulation (Regulation CC, "Availability of Funds and Collection of Checks") to implement the Expedited Funds Availability Act. The new regulation will go into effect on September 1, 1988. The following is adapted from a statement issued by the Board of Governors regarding the new regulation:

The Federal Reserve Board has issued a new regulation, Regulation CC, to carry out provisions of the Expedited Funds Availability Act. The regulation spells out when funds deposited in a bank by a customer in a transaction account must be available to the customer.

Congress adopted the Act last year after expressing growing concern about delayed availability — the length of time that some banks and other depository institutions place on checks deposited in customer accounts before the funds can be withdrawn.

Under the law and regulation, a temporary availability schedule provides for the withdrawal of funds by the third business day following deposit, if the deposit is a local check. A local check is one deposited in an institution located in the same Federal Reserve check processing region as the paying bank. There are currently 48 check processing regions in the country. Proceeds of nonlocal checks must be made available for withdrawal by the seventh business day following deposit under the temporary rules. Beginning on September 1, 1990, these schedules will be reduced to two business days for local checks and five business days for nonlocal checks.

Effective this September, receipt of electronic payments and deposits of cash, as well as deposits of some types of checks — such as Treasury checks, state and local government checks and cashier's checks — generally must be made available for withdrawal the day after deposit.

The regulation contains exceptions to the general rules which, in some instances, permit a bank to extend the hold on an account beyond the statutory schedule by a reasonable period of time.

Depository institutions are required to disclose their availability policy to new customers prior to opening an account, to existing customers, and to any person upon request. Disclosures are also required on preprinted deposit slips, at branch locations and at automated teller machines.

(OVER)

In addition to the availability rules, the regulation includes rules to speed the collection and return of checks in order to reduce the risk that banks incur by making funds available to their customers before learning that a check has been dishonored. In contrast to the high-speed automated processing involved in the forward collection of checks, the current check return system is a slow, labor-intensive operation. A bank returning a check must rely on deciphering the indorsements on the back of the check to determine where the return must be sent. Returns are often transported by mail, rather than courier, further slowing their trip to the depository bank. Moreover, checks are generally returned through each of the banks that collected the check, although this may not be the most efficient path to route the return. Therefore, it now takes more than three times as long to return a check as it does to collect a check.

Under the new rules, checks will be returned in much the same way they are collected. The new regulation enables banks to return checks directly to the depository bank using couriers and banks offering check return services. The regulation also encourages banks to qualify returned checks for automated processing by high-speed equipment. The regulation expands the current notice of nonpayment requirements of Regulation J to all returned checks of \$2,500 or more, including those checks that were not collected through the Federal Reserve, and shortens the time frame within which notices must be provided.

In order to facilitate direct returns and notice of nonpayment, on April 4, 1988, the Board adopted indorsement standards which will enable banks to more readily identify the depository bank to which the returned check or notice must be sent.

Enclosed — for chief executive officers of depository institutions in this District — is an overview of the new regulation. The overview, together with the text of the regulation itself and a description of new returned-check services that will be introduced to assist institutions in complying with the new regulation, will be published shortly in the *Federal Register*. When published, this material will be sent to all depository institutions in this District. Seminars will be held in June throughout the District on the regulatory and operational changes that will take place. Information regarding the dates of these seminars is being sent to you under separate cover.

Additional copies of the overview may be obtained from our Circulars Division (Tel. No. 212-720-5216). Questions on the new regulation related to disclosure requirements, compliance, or availability schedules should be directed to the Compliance Examinations Department (Tel. No. 212-720-8136); other questions should be directed as follows:

*Head Office*

Matthew J. Puglisi  
Manager, Check Processing Department  
(Tel. No. 212-720-6551)

*Cranford Office*

Fred A. Denesevich  
Regional Manager  
(Tel. No. 201-272-9000)

*Buffalo Branch*

David P. Schwarzmuller  
Operations Officer  
(Tel. No. 716-849-5018)

*Jericho Office*

Anthony N. Sagliano  
Regional Manager  
(Tel. No. 516-997-4500)

*Utica Office*

Angus J. Kennedy  
Regional Manager  
(Tel. No. 315-768-2220)

E. GERALD CORRIGAN,  
*President.*

FEDERAL RESERVE SYSTEM

[Docket No. R-0620]

Regulation CC

12 CFR Part 229

Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has adopted a new rule (Regulation CC) to implement the Expedited Funds Availability Act. This rule sets out the requirements that banks and other depository institutions make funds deposited into accounts available according to specified time schedules and disclose funds availability policies to their customers. Regulation CC also establishes rules designed to speed the return of unpaid checks.

The Board has also submitted the collection of information requirements in Regulation CC to the Office of Management and Budget (OMB) for its review under the Paperwork Reduction Act (44 U.S.C. 3501 et seq.) and OMB regulations on Controlling Paperwork Burdens on the Public (5 CFR Part 1320). The information collection requirements are contained in Regulation CC and published in this notice. Additional supporting documents may be obtained from the Board clearance officer listed below. Any comments on the collection requirements should be sent to the OMB desk officer listed below. OMB's usual practice is not to take any action on an

information collection until at least ten working days after notice in the Federal Register, but occasionally the public interest requires more rapid action.

EFFECTIVE DATE: September 1, 1988, except for 12 CFR 229.12, which is effective on September 1, 1990. After September 1, 1990, 12 CFR 229.11 will no longer be effective.

FOR FURTHER INFORMATION CONTACT: For information regarding Subparts A and C contact Joseph R. Alexander, Senior Attorney, (202/452-2489), or Stephanie Martin, Attorney, (202/452-3198), Legal Division.

For information on §§ 229.10 through 229.14, and §§ 229.19 through 229.21 of Subpart B, contact Louise L. Roseman, Assistant Director, Division of Federal Reserve Bank Operations (202/452-3874).

For information on §§ 229.15 through 229.18 of Subpart B, contact Gerald P. Hurst, Senior Counsel, (202/452-3667), Kathleen S. Brueger, Attorney, (202/452-2412), or Thomas J. Noto, Attorney, (202/452-3667), Division of Consumer and Community Affairs.

For the hearing impaired only: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3254).

Federal Reserve Board Clearance Officer, Nancy Steele, Division of Research and Statistics (202/452-3822).

OMB Desk Officer, Robert Neal, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3228, Washington, D.C. 20503 (202/395-7340).

SUPPLEMENTARY INFORMATION:

OVERVIEW

Delayed availability -- the holds that some banks<sup>1</sup> place on checks deposited into their customers' accounts before the funds may be withdrawn -- was a subject of growing concern in the Congress for a number of years. Many argued that the holds placed by many banks were unduly long, and that depositors have a right to prompt access to their funds. Banks that impose holds responded that their availability schedules reflect the time needed for the collection and return of checks returned unpaid by the paying bank and provide a measure of protection against the risk that the bank could not recover funds from the

---

<sup>1</sup> Regulation CC terminology corresponds with the terminology of the Uniform Commercial Code, with some modifications. "Bank" is defined to include all depository institutions. A "paying bank" is the bank on which the check is drawn. In the case of payable through drafts, the payable through bank is the paying bank. A "returning bank" is an intermediary bank handling a returned check. A "depository bank" is the bank in which the check was first deposited. (See § 229.2 of Regulation CC for the complete definitions of these terms.)

depositor if those funds had already been withdrawn from the depositor's account.

The Congress concluded that federal legislation was required to address delayed availability practices and passed the Expedited Funds Availability Act (the "Act") (Title VI of Pub. L. 100-86, enacted on August 10, 1987). The Act seeks to ensure prompt availability of funds and to expedite the return of checks; the Board is directed to issue regulations to implement the Act, which becomes effective on September 1, 1988.

The Act includes specific and detailed provisions requiring banks to: (1) make funds available to their customers within specified time frames, (2) pay interest on interest-bearing transaction accounts not later than the day the bank receives provisional credit, and (3) disclose their funds availability policies to their customers. These statutory provisions provide the Board with little flexibility in developing rules to implement the Act's requirements.

The Act requires that cash deposits, wire transfers, and certain check deposits that Congress believes pose little risk to the depository bank, such as Treasury checks and cashier's checks, generally be made available for withdrawal by the business day after the day of deposit. The time when the depository bank must make other check deposits available for withdrawal depends on whether the check is "local" or "nonlocal"

to the depository bank. A local check is a check deposited in a depository bank that is located in the same Federal Reserve check processing region as the paying bank. A nonlocal check is a check deposited in a different check processing region than the paying bank. There are a total of 48 Federal Reserve check processing offices in the United States, and the territory served by each office constitutes a check processing region.

Under the temporary schedule that becomes effective on September 1, 1988, a depository bank must make the proceeds of local checks available for withdrawal by the third business day following deposit; that is, the proceeds of local checks deposited on a Monday must be available for withdrawal by the following Thursday. The depository bank must make the proceeds of nonlocal checks available for withdrawal by the seventh business day following deposit; that is, the proceeds of a Monday deposit must be available for withdrawal by Wednesday of the following week. On September 1, 1990, these time periods are reduced. At that time, proceeds of local and nonlocal checks must be available for withdrawal by the second and fifth business day following deposit, respectively. Special rules are provided for cash withdrawals, deposits at nonproprietary automated teller machines, and deposits made in banks outside the continental United States.

Congress provided several exceptions to the availability schedules. When a bank invokes one of these exceptions, it may extend the hold on a customer's account beyond the statutory schedule by a reasonable period of time, as determined by Regulation CC.

The statute requires banks to disclose their availability policies to their customers and inform their customers that deposited funds may not be available for immediate withdrawal. Banks are required to provide disclosures to new customers prior to opening an account or upon request. In addition, disclosures are required on preprinted deposit slips, at staffed locations where consumers make deposits, and at automated teller machines. Banks must also provide notice to their consumer customers whenever their availability policies change.

The Act gives the Board authority to make improvements in the check collection and return systems in order to shorten the time within which depository banks learn of the nonpayment of checks, and thereby reduce the number of situations when the bank will be required by law to make funds available to its customers before it learns a check has been dishonored. The Board's authority is broad and general, and extends to checks that are not cleared through the Federal Reserve System. Previously, the Federal Reserve generally had the authority to regulate only those checks it collected.



The Board issued for public comment a proposed regulation and proposed Federal Reserve Bank services to implement the Act on December 3, 1987. (52 FR 47,112 (Dec. 11, 1987).) Over 1,000 comments have been received on the proposals.<sup>2</sup> Many of these comments were very thorough, and provided excellent analyses of issues raised in the proposal. A number of commenters stated that the proposal did a good job implementing the Act's requirements, and provided guidance that is essential for industry compliance. The commenters, however, expressed concern over the complexity of the Act and regulation, and the increased costs and risks to the banking industry due to the disclosure and funds availability requirements. In particular, many commenters were concerned with the risks inherent in the requirement to provide next-day availability for certain check deposits. This, as well as a number of other concerns, relate to statutory requirements the Board has little or no flexibility to modify.

---

<sup>2</sup> Approximately two-thirds of the commenters were commercial banks or bank holding companies. Ten percent of the comments were received from savings and loan associations, eight percent from corporations, five percent from credit unions, and the remainder from trade associations, clearinghouses, consumer groups, and others.

The Board and Board staff considered all comments received, and discussed aspects of the proposed regulation with the Consumer Advisory Council and the Return Item Advisory Group, which is a joint Federal Reserve/banking industry group, as well as representatives of both industry and consumer groups. Two consulting firms were retained to assess the effect of certain aspects of the proposal on the banking industry. Based on the analysis of the issues raised by the public comments and this additional input, the Board made a number of changes to the proposed regulation. Other provisions of the proposed regulation, including some of those criticized by commenters, were retained either because they are required by the Act, or because they are important to carry out the purposes of the Act.

#### Discussion

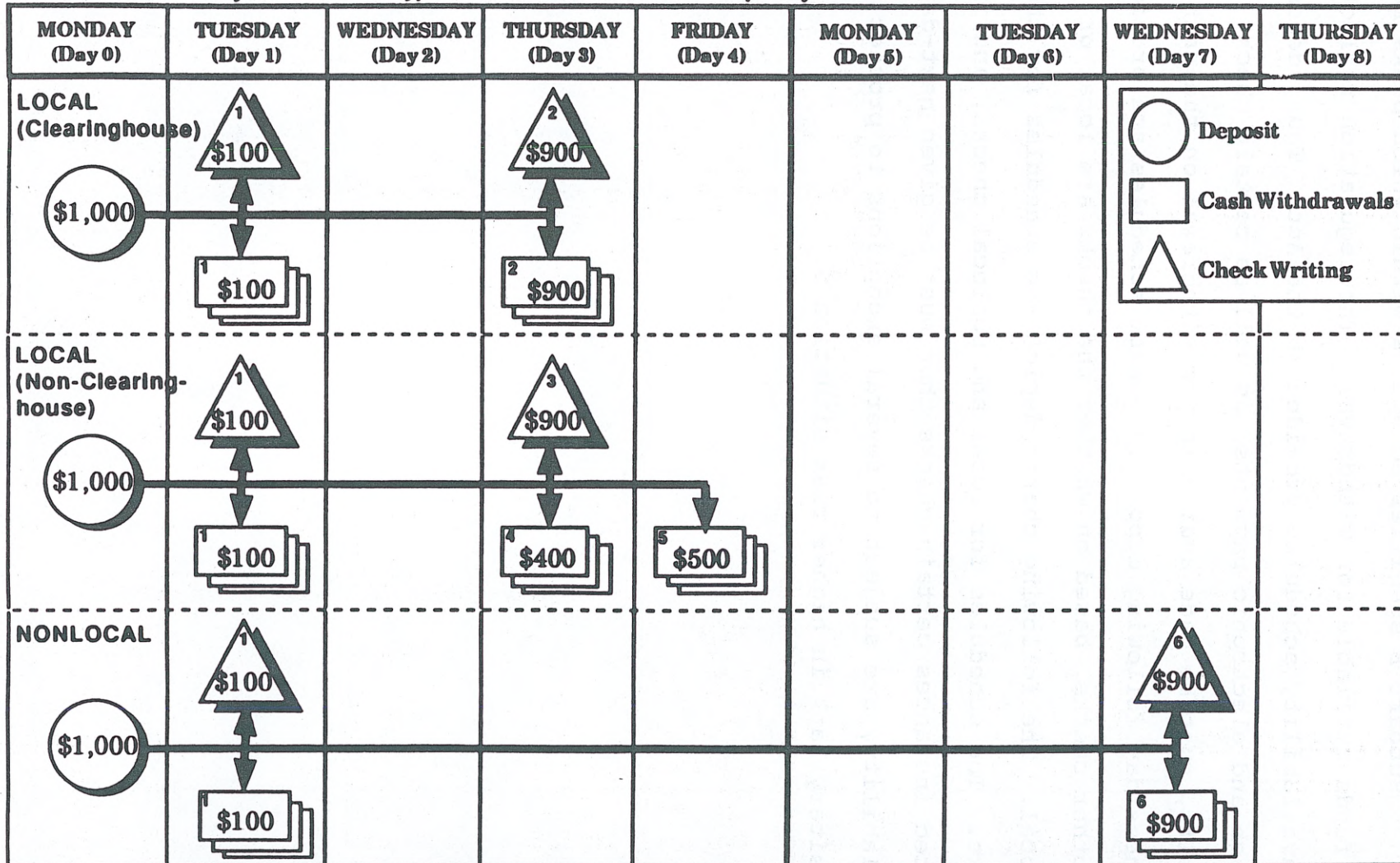
Regulation CC (12 CFR Part 229), Availability of Funds and Collection of Checks, contains three subparts. Subpart A defines terms and provides for administrative enforcement. Generally, the terms in the regulation are defined as they are in the Act. The Board has adopted a number of changes for the sake of clarity, to conform the terminology to that which is familiar to the banking industry, to define terms not defined in the Act, and to carry out the purposes of the Act.

Subpart B specifies schedules within which banks must make funds available for withdrawal. The regulation reflects the availability schedules provided in the Act. Thus, deposits of cash and electronic payments, as well as certain check deposits, must be made available for withdrawal on the next business day following deposit. Longer schedules are provided for other checks, based on whether the checks are local or nonlocal. The following charts depict the schedules for these checks. The schedules for local and nonlocal checks, and in limited instances certain checks that must be given next-day availability, are subject to several exceptions to protect the depository bank in higher risk situations.

# Temporary Funds Availability Schedules

Figure 1

Illustrates availability of different types of checks under the temporary schedules

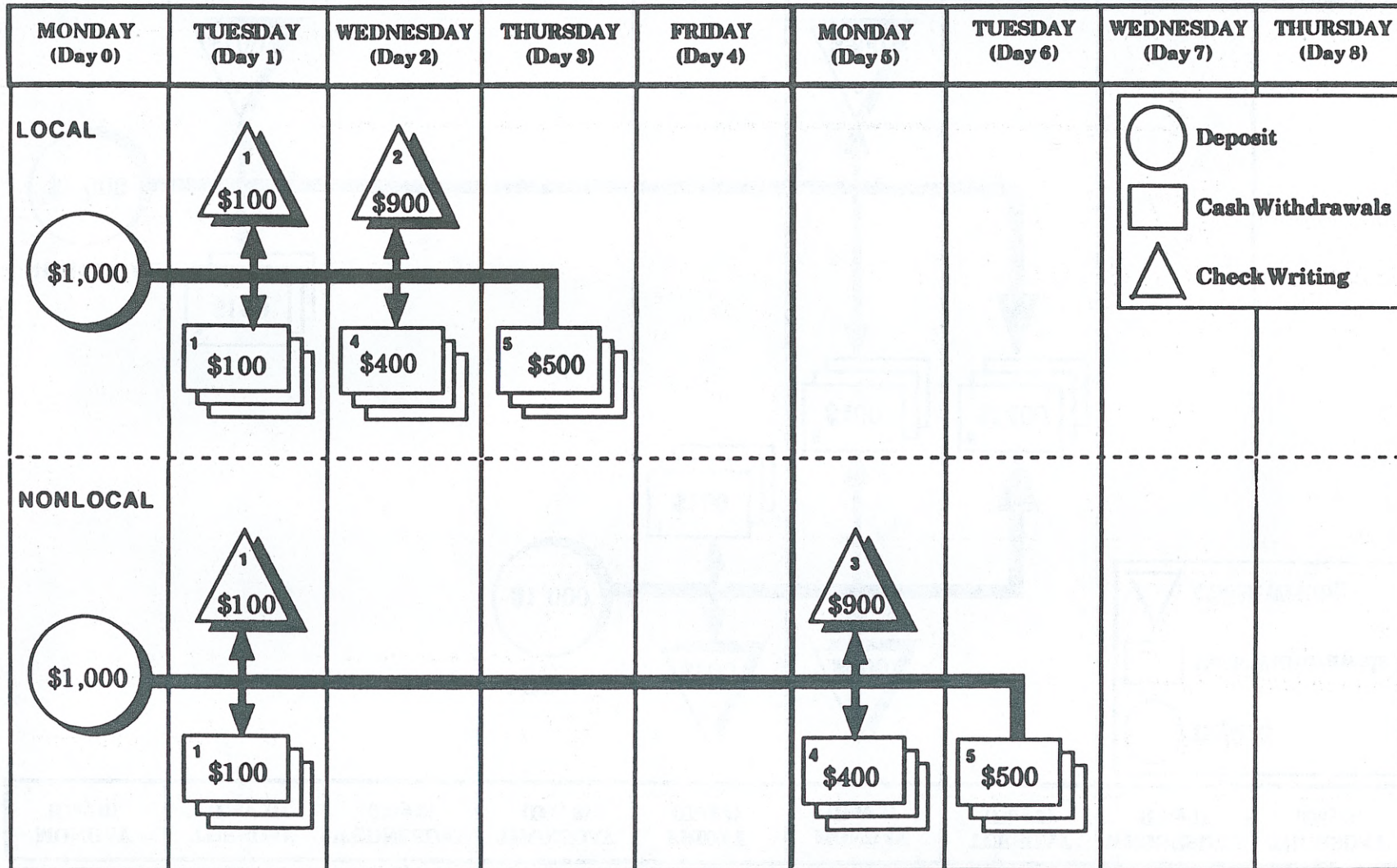


- 1 The first \$100 of a day's deposit must be made available for either cash withdrawal or check writing purposes at the start of the next business day § 229.10(c)(1)(vii).
- 2 For local checks cleared through a local clearinghouse, the remainder of the deposit must be made available for either cash withdrawal or check writing purposes by the third business day following the day of deposit § 229.11(b)(1).
- 3 For local checks cleared outside a local clearinghouse, the remainder of the deposit must be made available for check writing purposes by the third business day following the day of deposit § 229.11(b)(2).
- 4 For local checks cleared outside a local clearinghouse, \$400 of the deposit must be made available for cash withdrawal no later than 5:00 p.m. on the day specified in the schedule. This amount is in addition to the \$100 that must be made available on the business day following the day of deposit § 229.11(b)(2).
- 5 The remainder of the deposit must be available for cash withdrawal at the start of business on the following day § 229.11(b)(2).
- 6 For nonlocal checks, the remainder of the deposit must be made available for either cash withdrawal or check writing purposes by the seventh business day following the day of deposit § 229.11(c).

# Permanent Funds Availability Schedules

Figure 2

Illustrates availability of different types of checks deposited the same day, under the permanent schedules.



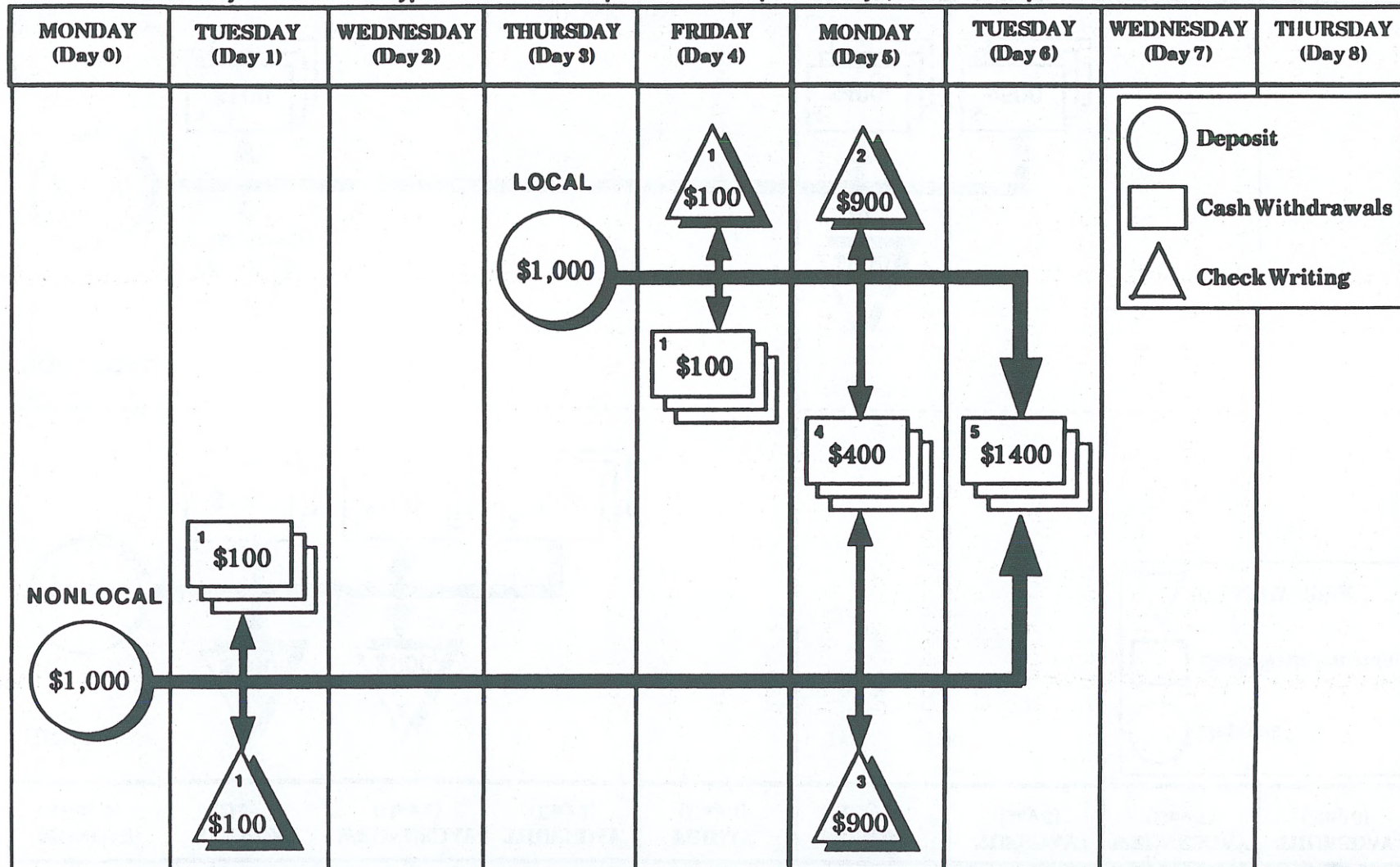
- 1 The first \$100 of a day's deposit must be made available for either cash withdrawal or check writing purposes at the start of the next business day § 229.10(c)(1)(vii).
- 2 Local checks must be made available for check writing purposes by the second business day following deposit § 229.12(b).
- 3 Nonlocal checks must be made available for check writing purposes by the fifth business day following deposit § 229.12(c).

- 4 \$400 of the deposit must be made available for cash withdrawal no later than 5:00 p.m. on the day specified in the schedule. This is in addition to the \$100 that must be made available on the business day following deposit § 229.12(d).
- 5 The remainder of the deposit must be made available for cash withdrawal at the start of business the following day § 229.12(d).

# Permanent Funds Availability Schedules

Figure 3

Illustrates availability of different types of checks deposited on separate days, under the permanent schedule.



- 1 The first \$100 of a day's deposit must be made available for either cash withdrawal or check writing purposes at the start of the next business day § 229.10(c)(1)(vii).
- 2 Local checks must be made available for check writing purposes by the second business day following deposit § 229.12(b).
- 3 Nonlocal checks must be made available for check writing purposes by the fifth business day following deposit § 229.12(c).
- 4 \$400 of the deposit must be made available for cash withdrawal no later than 5:00 p.m. on the day specified in the schedule. This applies to the aggregate amount of deposits that must be made available on a specified day, and is in addition to the \$100 that must be made available on the business day following deposit § 229.12(d).
- 5 The remainder of the deposit must be made available for cash withdrawal at the start of business the following day § 229.12(d).

Subpart B also includes rules regarding exceptions to the schedules, disclosure of funds availability policies, and payment of interest. The Act and regulation require banks to disclose their specific policy as to when deposited funds will be available for withdrawal to existing customers, to any person opening a new account, and to any person upon request. In addition, banks are required to disclose their availability policies in locations where consumer deposits are accepted by bank employees, and to provide reminders at ATMs and on preprinted deposit slips that deposited funds may not be available for immediate withdrawal.

Subpart C includes rules to speed the collection and return of checks. These rules cover the expeditious return responsibilities of paying and returning banks, authorization of direct returns, notification of nonpayment of large-dollar returns by the paying bank, check indorsement standards, and other related changes to the check collection system. The Board adopted the indorsement standard required by the regulation (Appendix D to Regulation CC) on April 4, 1988. (53 FR 11, 832 (April 4, 1988).) A discussion of the impact of Subpart C on the check collection system is summarized at the end of this overview.

Significant Changes in the Final Regulation CC

The following describes the substantive differences between the proposed regulation and the final Regulation CC.

Other significant issues and comments received on the regulation are highlighted later in this document.

1. Availability Schedules and Exceptions

Treasury Accounts. At the request of the Treasury, accounts held by the United States Treasury, such as Treasury General Accounts and Treasury Tax and Loan Deposit Accounts, are not subject to the availability and disclosure requirements of Subpart B of the regulation. (§ 229.2(a).)

Noncash Items. The Act and regulation exclude noncash items from the definition of check. Thus, noncash items are not subject to the funds availability requirements of the statute and regulation. A number of commenters asked the Board to clarify that accepting checks on a collection basis is permitted under the regulation, and that such checks are not subject to the regulation's availability requirements.

While the regulation does not generally authorize banks to take checks for collection as an alternative to taking them for deposit subject to the statutory schedules, it does permit certain current bank practices of taking checks for collection. For example, at the request of a customer, a bank may take a check on a collection basis, handle the check as a noncash item, and send it directly to the paying bank with special payment instructions. This practice enables a bank's customer to know whether a check is being paid or dishonored. Taking checks for collection under these circumstances is not subject to the availability schedules in the Act. (§ 229.2(u).)



Deposits of next-day checks at unstaffed facilities.

The Act provides next-day availability for cash deposits and certain check deposits to accounts at a depository bank "staffed by individuals employed by such institution." (The Act does not require, however, that Treasury checks and "on us"<sup>3</sup> checks be deposited at a staffed teller station in order to receive next-day availability.) The proposed regulation required that these deposits be made available on the next business day, whether or not they were deposited in person to an employee of the bank. The Board requested comment on whether this expansion of the Act's requirement would pose any operational problems.

Commenters strongly opposed this expansion of the next-day availability requirement, indicating that it would be very difficult to make funds available on a next-day basis for deposits made at automated teller machines (ATMs) and other facilities other than staffed teller stations. They stated that it is often not possible to collect and verify deposits made at unstaffed locations in time to make the funds available at the start of business on the following day. To address the operational concerns of the banks, the final regulation conditions the receipt of next-day availability to deposits (other than the deposit of Treasury checks and on us checks) "made in person to an employee of the depository bank," in

---

<sup>3</sup> Checks drawn on the depository bank.

accordance with the Act. The Board believes that extending the hold on these deposits to the local and nonlocal schedules is not warranted by these operational concerns. Thus, the regulation provides that deposits that are eligible for next-day availability that do not meet this condition must be made available for withdrawal by the start of the second business day following deposit. (§ 229.10(c).)

ATM cut-off hours. In addition to the next-day availability requirements, commenters cited other provisions of the proposed regulation that would be very difficult to implement operationally with respect to accepting deposits at, and permitting withdrawals from, ATMs. Some of their concerns focused on what constitutes the start and close of a day for the purpose of ATM withdrawals and deposits. The proposed regulation enabled banks to establish a cut-off hour of 2:00 p.m. or later for deposits considered received on a given day. To provide greater flexibility in the servicing of ATMs, the final regulation allows a cut-off time as early as 12:00 noon for the receipt of deposits at ATMs and other off-premise facilities. (§ 229.19(a).)

Start of business. The regulation generally requires that funds be made available for withdrawal at the start of business on the day specified in the schedule. The proposed regulation provided that the start of business was generally the time the branch opens to the public, and, in the case of ATMs, not later than 7:00 a.m. In response to comments that customer

accounts often cannot be updated with the day's opening balance by 7:00 a.m., the regulation has been modified to require a 9:00 a.m. start of business for ATM withdrawals. (§ 229.19(b).)

Notice of reasonable cause to doubt collectibility exception. The Act and regulation provide an exception to the availability schedules for instances where a depository bank has reasonable cause to doubt whether a particular check will be collected. Commenters expressed concern regarding the manner in which the reason this exception is invoked must be disclosed, as required by the Act, if the reason relates to confidential information, such as the pending insolvency of the drawer of the check or the paying bank. The Commentary to the regulation has been expanded to provide guidance on how the bank must disclose, in the notice it provides its customer, the reason this exception has been invoked. The revised Commentary provides that in such cases, the bank may disclose to the customer that the exception is being applied based on confidential information. The bank is required to include in its records a brief statement of the facts upon which the determination to invoke this exception was based. (§ 229.13(e) and § 229.13(g).)

Cash Withdrawal Limitation. Certain banks limit the amount of cash a customer may withdraw on any day at ATMs and/or staffed teller facilities. The proposed regulation did not prohibit these limitations as long as the bank's policy is applied without discrimination to all customers of the bank, is not dependent on the length of time the funds have been in the

account (as long as the hold has expired), and is related to security requirements or bonding limitations of the bank. Commenters believed this policy is overly restrictive, particularly in the case of policies related to ATM cash withdrawal limits. The final regulation does not prohibit cash withdrawal limitations at ATMs if the bank's policy is not dependent on the length of time the funds have been the account, and in the case of limits on over-the-counter cash withdrawals, is applied without discrimination to all customers, and is related to security, operating, or bonding requirements of the bank. The regulation does not authorize such policies if they are otherwise prohibited by statutory, regulatory, or common law. (§ 229.19(c).)

Repeated Overdrafter. The proposal contained an exception to the availability schedules for deposits to accounts of repeated overdrafters. Commenters suggested that the proposed exception would be very difficult operationally to implement. The final rule is revised in an effort to simplify the application of this exception. The exception now defines a repeated overdrafter as a customer that overdraws its account, or bounces checks, on six or more banking days during a six-month period, or on two or more banking days during a six-month period in the amount of \$5,000 or more. (§ 229.13(d).)

Time Period for Exceptions. The proposed regulation allowed a bank to extend the availability schedule by not more than four business days when it invokes an exception to the

regulation's availability schedule. The final regulation allows a bank to extend the schedule by a reasonable period of time, and states that an extension of up to four business days is a reasonable period. An extension of more than four days may be reasonable, but the bank has the burden of so establishing.

(§ 229.13(h).)

Relation to State Law. The Act provides that a state law supersedes federal law if it requires that funds be made available more promptly than required by federal law. Other provisions of state law that are inconsistent with the Act or regulation are preempted. This standard is broader than those of other consumer statutes, such as the Electronic Fund Transfer Act and Fair Credit Billing Act, which provide for preemption of provisions of state law that are inconsistent, "and then only to the extent of the inconsistency."

The proposed regulation included standards that would be applied to determine whether state law relating to the time funds must be available for withdrawal are inconsistent with federal law, and thus preempted. The proposal did not, however, provide standards for determining whether state disclosure requirements related to funds availability are inconsistent. The Board provided, in the regulation, that disclosures or notices concerning availability provisions of state law relating to transaction accounts are preempted by the requirements of Regulation CC. (229.20(c).)

2. Interest Accrual

Use of Fractional Availability. The Act requires that a bank begin to accrue interest on interest-bearing accounts not later than the day it receives provisional credit on the funds deposited. To facilitate compliance with this requirement, the final regulation permits a bank to begin accruing interest on check deposits based on the average availability the bank receives on such deposits on a bank-wide basis. (229.14(a).)

3. Disclosures

Case-by-Case Hold Policy. The proposed regulation required as a general rule that banks disclose their specific policy in a way that would allow customers to determine when a particular deposit would be available for withdrawal. The proposed regulation provided a simplified alternative disclosure for banks that generally make funds available on the business day following the day of deposit, and place holds only on a case-by-case basis. This proposed alternative disclosure required a bank to disclose that it usually provides next-day availability, although from time to time it may hold deposits for a longer specified time, and that if a longer hold was imposed, the customer would be notified. The proposal required that the bank furnish the notice that availability of a deposit was going to be delayed at the time the deposit was made. A bank could provide notice of the delay later, if the bank informed the customer that a hold might be placed at the time of

the deposit, and then notified the customer by the end of that day if a hold was in fact going to be placed on the deposit.

Generally, the commenters favored an alternative disclosure for banks that had case-by-case hold policies. Several commenters, however, asked that the ability to use the case-by-case disclosure not be limited to banks with a policy of next-day availability. In addition, commenters objected to the timing of the notice requirement when a bank imposed a case-by-case hold. Specifically, commenters stated that a teller may not know whether a check will be held, and thus would not be able to inform the customer of the possibility of a hold at the time of the deposit. In addition, commenters stated that the requirement that the bank notify the customer of any hold on the day of the deposit was too restrictive.

The Board adopted modifications to the proposed disclosure requirements to address these concerns. The modified disclosure rule does not limit the case-by-case alternative to banks that generally give next-day availability. Instead, the rule allows any bank that generally makes funds available for withdrawal sooner than is required in the regulation to use this alternative disclosure.

A bank that extends a hold on a case-by-case basis must provide notice to its customer within the same time frames as the notice that is required when an exception to the availability schedules is invoked. Thus, a bank would be required to provide a notice at the time of deposit if the

deposit is made at a staffed teller station and the decision to extend the hold is made at the time of deposit. Otherwise, the bank must mail the notice of the hold to the customer not later than the business day following the day of deposit. In addition, the final rule also parallels the requirement applicable to the reasonable cause exception by prohibiting a bank that does not provide a notice of a hold at the time of the deposit from imposing service fees or charges for overdrafts or returned checks resulting from the hold, if the check subject to the hold is in fact paid. (§ 229.16(c).)

ATM Notice. The proposed regulation contained special notice requirements for ATMs at which customers of banks other than the bank to which the ATM is proprietary are able to make deposits. The proposed notice included a requirement to identify the bank to which the ATM is proprietary. These requirements generated concerns as to consumer confusion, competitive effect, disclosure burden, and effect on state law. The final regulation eliminates the requirement to identify the bank to which an ATM is proprietary at the ATM, but a bank that extends the time period applicable to deposits at nonproprietary ATMs must explain its policy in its initial disclosure and either provide a list of proprietary or nonproprietary ATMs with that disclosure, or identify the bank's name on all proprietary ATMs. (§ 229.18(c).)



Branch Location Notice -- Drive-Through Teller Windows. The Act requires that a notice of time periods applicable to the availability of funds be posted in each location where employees accept deposits. The proposed regulation required this notice to be posted in the lobby at some place where customers would be likely to see it before making their deposits, and required that the notice also be posted at any drive-through teller windows. Commenters noted the practical problems the drive-through requirement would generate and the fact that the Act itself is silent on the matter. The requirement that this notice be posted at drive-through teller windows has been eliminated in the final regulation. (§229.18(b).)

Change in Terms Notice. The proposed regulation required that notices of changes in availability policy be sent to all customers. The final regulation limits this requirement to consumer accounts, consistent with the statutory requirement. In addition, the Commentary provides that banks are not required to send a change in terms notice if the Board revises Appendix B, which lists the routing numbers of certain nonlocal checks that are subject to prompter availability than the nonlocal schedule. (§ 229.18(e).)

#### 4. Check Return Rules

Standards for expeditious return. The proposed regulation required paying and returning banks to return checks

expeditiously, using the forward collection process as the standard for expeditious return. A number of commenters stated that this standard was uncertain, particularly in comparison to the current midnight deadline rule, and expressed concern that litigation in this area may increase as a result. These commenters asked that a more definitive standard for expeditious return be provided.

The forward collection standard, rather than a specific number of days for return, was proposed as the standard for expeditious return to facilitate compliance for banks, particularly country banks or banks returning checks to country banks, that require a longer period of time to return checks to a depositary bank. In order to respond to commenters' concerns, the final regulation contains a second test of what constitutes expeditious return by a paying or returning bank. Under this second test, a bank satisfies its return requirements if it returns a check so that the check would normally be received by the depositary bank within two days after the check is presented in the case of a local paying bank or four days after the check is presented in the case of a nonlocal paying bank with respect to the depositary bank. If a check is not received within these time frames, the return would still be expeditious if the return process met the forward collection standard. The Board believes that the combination of these rules will speed the return of checks so that the majority of checks can be collected and returned within the temporary statutory availability schedules.

At the same time, it provides a workable standard that can be implemented by paying banks and correspondent banks offering check return services. (§§ 229.30(a) and 229.31(a).)

Expeditious Return -- Notice Option. Under the proposed regulation, a bank could fulfill its responsibilities to return checks expeditiously by providing a notice of nonpayment expeditiously, with the check returned in a slower manner. Commenters opposed this notice alternative, stating that notices are often inaccurate, and consequently the depository bank often cannot charge back the customer's account with confidence based on a notice. Commenters did not believe that this notice alternative was warranted, and stated that the paying bank should be required to return the check itself in an expeditious manner. The final regulation eliminates notice as an option for meeting the duty of expeditious return. (§ 229.30(a).)

Unidentifiable Depository Bank. The proposed regulation permitted a paying or returning bank to send a returned check to a bank that handled that check for forward collection, even if the collecting bank does not agree to act as a returning bank. In response to comments that it was unreasonable to impose expeditious return requirements on banks that did not hold themselves out as returning banks, the final regulation limits this option for return to cases where the paying or returning bank is unable to identify the depository bank with respect to a returned check. In these cases, the bank

may send the check to a bank that handled the check for forward collection, if the bank advises the collecting bank that it is unable to identify the depository bank. Checks that must be returned in this manner are not subject to the expeditious return requirements. (§§ 229.30(b) and 229.31(b).)

Notice in Lieu of Return. If a check is unavailable for return, a paying or returning bank can send in its place a notice in lieu of return. The depository bank must treat this notice as it would a returned check. The proposed regulation permitted electronic notices in lieu of return. Commenters stated that allowance for electronic notices in lieu would entail significant accounting and reconciliation problems. The final regulation requires a notice in lieu of return be in the form of a copy of the returned check, and if no such copy is available, a written notice. (§§ 229.30(f) and 229.31(f).)

Midnight deadline extension for checks of \$100 or less.

One of the objectives of the proposed regulation was to reduce the volume of checks that are returned. Over one-half of all returned checks are in amounts of \$100 or less. Many of these returns are automatically redeposited, and over 60 percent are paid on the second presentment. To eliminate many of these returns entirely, the proposed regulation allowed the paying bank to hold checks of \$100 or less for an additional two business days beyond its midnight deadline in an effort to secure payment.

Most of the respondents that commented on this provision opposed its inclusion in the final regulation. Banks asserted that this practice would create accounting and reconciliation problems, as well as the customer relations problems arising from the imposition of returned check charges. Banks also argued that unlike an automatic redeposit service, where the depository bank makes the decision to redeposit the check and incur the risk that the check may be returned a second time, this provision placed the decision to hold the checks an additional two days on the paying bank, although the risks remain with the depository bank or its customer. Very few commenters indicated that they would use this optional authority. Therefore, the Board has deleted from the final regulation the provision to hold low-dollar checks an additional two business days, in an effort to obtain payment.

Notice of Nonpayment. Notice of large-dollar returns is now required only for those checks collected through the Federal Reserve. The proposal expanded this requirement to all checks of \$2,500 or more, regardless of the channel through which they were cleared, and reduced the time within which notice must be received by the depository bank. Commenters generally supported this requirement, but recommended several modifications. A number of technical changes have been made to the final regulation. These include changes that address cases in which the paying bank cannot determine with reasonable certainty from

the check all of the required information for the notice, as well as locations at which depository banks must accept notices of nonpayment. The final regulation also addresses the depository bank's duty to notify its customer that a check is being returned, and the paying bank's responsibility for giving notice of nonpayment and subsequently returning the check. (§§ 229.33 and 229.34(b).)

Indorsements. The final regulation includes indorsement standards and rules for depository banks, subsequent collecting banks, and returning banks. The Board approved these indorsement standards on April 4, 1988. One subsequent modification to the indorsement standard was made to eliminate the requirement that the depository bank indorsement avoid the MICR clear band along the bottom of the check. (§ 229.35(a); Appendix D.)

Inquiry to Paying Bank. To address the concerns of the banking industry regarding the risks inherent in providing next-day availability for cashier's, certified, and teller's checks, the proposed regulation included a duty on the paying bank to respond to inquiries regarding the authenticity of official checks that it issued. The final regulation eliminates this requirement, due to operational difficulties noted by the commenters.

Liability -- Responsibility for Back of the Check. The final regulation defines the liability of the paying and depository bank for untimely returns due to unreadable indorsements caused by material on the back of the check. The paying bank is responsible for the condition of the back of the check when it is issued. Thus, an unreadable indorsement due to a carbon band, printed contract, or other material on the back of the check at the time it is issued is the responsibility of the paying bank. The depository bank is responsible for the condition of the check after issuance and before acceptance by the depository bank, such as indorsements or other stamps placed on the check by its customer or a prior indorser. (§ 229.38(d).)

Liability -- Bona Fide Errors. Under the proposed regulation, a bank would not be liable for a violation of the return rules of Subpart C if the violation were due to a bona fide error. The liability standard in the final regulation provides that a bank is required to exercise ordinary care and act in good faith, without the shield of the bona fide errors provision. The bona fide errors shield is not necessary, as the standards for negligence liability incorporate the purpose of the bona fide error provision. (§ 229.38(a).)

Exclusions. Under the proposed regulation, U.S. Postal Service money orders, checks drawn on the account of the U.S. Treasury, and checks indorsed by, or for credit to, the Treasury,

were excluded from the expeditious return requirements of Subpart C. At the request of the Treasury, the final regulation eliminates the exclusion for checks indorsed by, or for credit to, the Treasury. The final regulation also excludes checks drawn on a state or local government from the expeditious return requirement. (§ 229.42.)

Variation by Agreement. A number of commenters asked that banks be explicitly permitted to vary the requirements of the regulation by agreement, as is permitted under the Uniform Commercial Code. There are a number of situations where an allowance for variation by agreement would be useful. For example, a depository bank may wish to limit its liability to its depositor, or a paying bank to its customer, for late return due to material on the back of the check by the depositor or customer that obscures the depository bank's indorsement. The final regulation permits variation by agreement for the provisions of Subpart C check return rules. Persons that are not party to the agreement, however, are not bound by the variations of the regulation's requirements. Banks are not authorized to vary the requirements of the funds availability and disclosure requirements of Subpart B by agreement. (§ 229.37.)

Transition Rule for Merged/Acquired Banks. Commenters stated that it would be extremely difficult to comply with certain requirements of the regulation for a period of time



following a merger or acquisition of a bank. These difficulties arise from having to treat the banks that have merged as one entity, before the operations of the banks have been consolidated. New provisions have been added to the regulation to provide a one-year transition period for merged/acquired banks, during which they may be treated as separate banks for certain purposes. (§§ 229.19(g) and 229.40.)

Federal Reserve Bank Services (Docket No. R-0621)

Returned check services. The Board has adopted new Federal Reserve Bank returned check services designed to facilitate bank compliance with the regulatory requirements to return checks expeditiously, effective September 1, 1988. These services were published for public comment in December 1987. (52 FR 47,171 (Dec. 11, 1987).) Under the new services, Federal Reserve Banks will accept and process any returned check, and return the check directly to the local depository bank or a processing center designated by the depository bank, bypassing any intermediary collecting banks in the indorsement chain. Direct return of checks will reduce the time required to return checks to the depository bank. In contrast, today a Federal Reserve Bank only accepts and processes returned checks that it collected, and returns each check to the bank that deposited the check with the Reserve Bank for forward collection.

Reserve Banks will also accelerate their processing of returned checks. Beginning September 1, 1988, local returns will be processed on an overnight basis and dispatched with the forward collection checks the next morning. Nonlocal returns will be prepared for high-speed processing ("qualified") by the first Federal Reserve office and dispatched to the second Federal Reserve office the following night. The Federal Reserve offices will also accept returned checks that have been qualified by the paying bank or prior returning bank, and dispatch them as quickly as forward collection checks. Today, local returns are processed during the day, and dispatched one day later. Moreover, nonlocal returns are processed manually by two Reserve Bank offices, adding an extra day to the return process.

With the introduction of new returned check services, returns will be priced explicitly, with the returned check fees assessed on the paying or returning bank depositing returns with the Federal Reserve Bank. Forward collection fees will be reduced due to the elimination of the return cost component. Currently, the Federal Reserve does not explicitly price returned checks; instead, the costs of handling returns are incorporated in the Reserve Banks' forward collection fees. Reserve Banks will also offer a same-day notification service for all large-dollar returned checks. Beginning on January 1, 1989, any depository bank that has an on-line electronic connection with

funds transfer capabilities with the Federal Reserve must receive large-dollar notices of nonpayment electronically.

The Board has approved additional 1988 expenditures to implement the new returned check service offerings, not to exceed \$15,000,000 in capital expenditures and \$15,000,000 in operating expenditures. The costs of providing these services will be recovered by the Reserve Banks through the fees assessed for the services.

Truncation and extended MICR capture services. As part of the December 1987 package, the Board proposed to make the truncation service being piloted by six Reserve Banks a permanent service that could be offered by all Reserve Banks. In truncation, the MICR-line information on the check is captured and presented to the paying bank electronically, while the paper checks are retained by the presenting bank. Although initially Reserve Banks would provide a truncation service to paying banks who request this service on a local basis only, eventually the Federal Reserve System intends to provide a national interbank truncation service; that is, truncation at the first Federal Reserve Bank to receive the check. Private sector service providers would be able to participate in a nationwide network under the rules of the National Association for Check Safekeeping (NACS). One Reserve Bank is now engaged in interbank truncation on a pilot basis, under the NACS rules.

The benefits of truncation include expeditious check processing and return and a reduction in the number of times the paper check is handled. The benefits of truncation will increase as checks are truncated earlier in the collection process. The Board also requested comment on a proposed service that offers many of the same benefits of truncation without stopping the flow of the paper check -- the extended MICR capture service. Under this service, which has also been provided on a pilot program basis, Reserve Banks would deliver payment information by electronic transmission or magnetic tape, provide returned check and retrieval service, and deliver the checks to the paying bank several days later using less time-critical transportation.

The Board approved an expansion of the Federal Reserve's truncation and extended MICR capture pilot programs to permanent services for all Federal Reserve offices, effective July 15, 1988. (See Docket R-0621 for additional information on truncation and extended MICR capture services.)

Effect of the Proposal

Cost effect. The requirements of the Act and regulation will result in several benefits to the public. Transaction account customers will be given specific information on when funds will be made available for withdrawal, which should help them better manage their accounts. In addition, many customers will gain earlier access to their funds.

A number of commenters indicated, however, that the overall costs to the banking industry to implement the availability and disclosure requirements will be quite significant. For many banks, these requirements will result in higher operating expenses and lost investment income due to earlier withdrawal of collected balances. There is also a potential for increases in bad check losses that may result from the availability requirements. In particular, the commenters stated that banks will be exposed to an unacceptable level of risk from the requirement that certain check deposits, such as cashier's checks and certified checks, be made available for withdrawal at the start of the next business day following deposit, regardless of the amount. The next day availability of these checks, however, is a requirement of the Act.

While the improvements to the check return system provided in Subpart C of the regulation may increase costs to the banking industry in the short term as banks adjust to the new processing environment, these initiatives may result in a reduction of the overall cost of processing returns in the long run. Returns will be received by the depository bank more quickly than they are today, reducing the bank's risk from providing prompt availability of funds to its customers. Returned checks will be handled by a smaller number of intermediary banks, due to the direct return provisions in the

regulation. The availability and disclosure requirements may result in a reduction in the number of returns, because funds may be available for withdrawal sooner, and customers would know more precisely when they may withdraw funds from their accounts. Most importantly, the new indorsement standard should facilitate the more efficient processing of returns by making the depository bank more readily identifiable. Future enhancements to the indorsement standard would allow all parties in the check collection system to automate their return processing completely, thus further lowering costs.

Competitive Effect. An important factor considered in the development of the regulatory framework for expedited returns and related Reserve Bank services was the effect on competition in the check collection system. In this regard, the Board requested comment on whether there are any returned check services or other procedural changes for returning banks that the Federal Reserve did not propose that might assist the returning bank in providing returned check services.

Commenters' primary concerns with the implementation of the proposed Federal Reserve services centered around the potential for the Federal Reserve to become the predominant provider of returned check services, given the availability schedules and deadlines that will be provided by the Federal Reserve Banks. Several commenters urged that the Federal Reserve

delay offering returned check services or, at a minimum, delay unbundling returned check costs from forward collection prices until correspondent banks and other interested parties could develop their own returned check products and get some experience with the market pricing mechanism. There were also comments suggesting that the Federal Reserve has an unfair competitive advantage due to its role as regulator and service provider, and its lower price structure, due, in part, to the fact that the Federal Reserve does not incur certain costs, such as presentment fees, that the private sector must pay.

The Board implemented the requirements in Subpart C of Regulation CC to improve the check return process effective September 1, 1988, in conjunction with the effective date of the funds availability and disclosure requirements mandated by the Act. Industry representatives indicated that implementation of these improvements concurrent with the effective date of the funds availability requirements is important to minimize risks to the depository bank from making funds available on a more prompt basis.

To enable banks to comply with these requirements, the Federal Reserve Banks will begin offering returned check services that would meet the requirements in the Act on September 1, 1988. Handling of returned checks by the Federal Reserve must be explicitly priced with the introduction of these new services,

since return costs cannot be recovered through the Federal Reserve Banks' forward collection fees as they are today. Some returned checks handled by the Federal Reserve under the new services will not have been collected through the Federal Reserve, and thus will not have been subject to the Federal Reserve's forward collection fees. In addition, paying banks and returning banks will be able to deposit returned checks with the Federal Reserve in various ways that result in different costs being incurred by the Reserve Banks. To provide correspondent banks with as much advance notice as possible in order to develop competing returned check services, the Board published, on April 4, 1988, estimated price ranges and deadlines for the new Federal Reserve returned check services. It is the Board's belief that the proposed services meet the standards that the Federal Reserve has established for priced services, as they will recover costs; yield clear public benefits by speeding the handling of returned checks; and because initially, adequate returned check services are unlikely to be provided by the private sector.

#### Educational Efforts

During the public comment period, Federal Reserve Banks conducted over 220 seminars throughout the country to explain the requirements of the proposed regulation, and better prepare the



public to comment on the Board's proposals. Approximately 17,500 participants attended these seminars, representing over 9,000 depository institutions. The Federal Reserve Banks plan to conduct additional seminars in June, to assist the industry in preparing for the regulatory and operational changes to be effective on September 1. In addition, Federal Reserve staff is working closely with various industry groups with similar seminars they plan to offer their constituencies.

Effect of the New Return Rules on the Check Collection System

The following is an explanation of the current process for returning checks and a description of the responsibilities of paying, returning, and depository banks now and in the future, under the check return requirements of Regulation CC. This overview should assist the reader in better understanding the effect of the proposed changes to expedite the return of checks on paying banks, returning banks, and depository banks.

In contrast to the forward collection process, the returned check process is a slow, relatively labor intensive, and costly operation. A study prepared for the Bank Administration Institute concluded that, while the forward collection process takes an average 1.6 days to complete, the return process takes an average of 5.2 days. (Return Items Study, Final Report, prepared for the Bank Administration Institute by J.D. Carreker and Associates, Inc. (May 1985), "BAI Study.") The BAI study found that, during the return process, the average returned check

is handled by 3.4 banks: the paying bank, an average of 1.4 returning banks, and the depository bank. Even though less than one percent (the study estimated 0.86 percent) of all checks are returned, the absolute volume of returns (the study estimated 350 million annually) is relatively large.

The BAI Study found that approximately 40 percent of returned checks take seven days or longer to complete the collection and return cycle and 15 percent take 10 days or longer. Under the temporary schedules, the proceeds of local checks must be available for withdrawal on or before the third business day after deposit and the proceeds of nonlocal checks must be available for withdrawal on or before the seventh business day after deposit. Under the permanent schedule, proceeds of local checks must be available for withdrawal on or before the second business day after deposit and proceeds of nonlocal checks must be available for withdrawal on or before the fifth business day after deposit. Approximately one-third of the checks handled by the Federal Reserve Banks would be considered nonlocal under the Act.

Both correspondent banks and Federal Reserve offices frequently act as returning banks between the paying and depository banks in the return process. Correspondent banks may route forward collection checks for payment either through the Federal Reserve or through private channels. Thus, the return

process currently may include one or more correspondents and the Federal Reserve before the returned check reaches the depository bank. The more intermediate processing steps a returned check must pass through on its route to the depository bank, the greater the probability that additional time will be necessary to complete the process.

Many checks are collected through local clearing arrangements, clearinghouses, and direct exchange arrangements. Such arrangements consist of two or more banks agreeing to exchange checks drawn on each other. There are many such arrangements, and they are a very efficient and fast means of collecting and returning certain checks. The returned check processes of local clearinghouses should be largely unaffected by the Board's proposals, although the individual participants are subject to the provisions of the Act.

#### The Paying Bank

Current. Today, the paying bank's principal duty when returning a check is to assure timely dispatch of the check back to the presenting bank. The U.C.C. and the Federal Reserve's Regulation J specify that the paying bank must dispatch a check it has determined not to pay by midnight of the banking day following the day the paying bank received the check for payment (the "midnight deadline"). This obligation may be satisfied by dispatching the returned check by courier or by mail. The return

of checks presented for payment through clearinghouses is usually subject to the rules of the clearinghouse and these checks are dispatched accordingly.

Typically, paying banks receive checks for payment throughout the day: from correspondents, the Federal Reserve, or through a clearinghouse. Checks received on a Monday, for example, would be posted to customers' accounts on Monday night and any checks that are not to be paid (due to insufficient funds, account closed, etc.) are rejected from the system and reports are prepared for management review. The actual decision to return a check can be made automatically as a matter of bank policy or following review by management on Tuesday. The checks to be returned are then sent by courier with the bank's forward collection checks, by mail or courier to other collecting banks, or by messenger to the clearinghouse. The return process in this example must begin by midnight Tuesday to conform to the U.C.C. Because the return process must begin by midnight, many paying banks return checks by mail when a courier leaving after midnight would be faster. If a check to be returned was presented by the Federal Reserve and is for \$2,500 or more, the paying banks is also obligated to provide notice of return to the depository bank by midnight of the third banking day following receipt (Thursday in this example). Receipt of the physical check by the depository bank within this time frame would fulfill this notification requirement.

Many paying banks currently receive checks from more than one collecting bank and, therefore, dispatch returned checks to each of those banks. If the paying bank does not deposit checks for collection with the bank to which it is returning checks, these checks are usually returned through the mail. In some cases, mail is also used by paying banks to transport returns to the bank to which it sends its forward collection checks in order to ensure compliance with the midnight deadline. The paying bank currently has little incentive to make an effort to speed the return process and is generally not concerned about the return process after a returned check has been dispatched timely.

New return rules. A major impetus for change in the role of the paying bank will be the responsibility placed on the paying bank by § 229.30 of the regulation. This section states that the return process must be accomplished in an "expeditious manner," thus providing the incentive to the paying bank to take steps to speed the flow of returned checks. Under this new duty, the paying bank must dispatch returned checks with the same speed and diligence that it would dispatch forward collection checks received for deposit by noon on the banking day after the day of presentment of the returned check. This means that a check presented to the paying bank on Monday that is not paid must be dispatched as quickly as a check deposited in that bank on

Tuesday morning that is drawn on the depository bank. A paying bank also returns a check expeditiously under the new rules if it returns a local check to the depository bank within two business days following presentment, or a nonlocal check within four business days following presentment. The Federal Reserve will provide new deadlines for deposit of returned checks and other new or enhanced services, to assist paying banks in meeting the regulation's new duties.

Some of the changes in the return process from the perspective of the paying bank will be:

1. In many cases, paying banks will dispatch returns by the same manner, and at the same time, as they send forward collection checks. This will usually mean that returns will be sent via courier rather than mail. The paying bank will be required to meet the deposit deadlines and sorting requirements set by any returning bank to which the returned check is sent.
2. Additional options will be available to send returns. Returns would not be required to follow the indorsement chain through which the check was originally collected. This means that the paying bank could return all checks to a single returning bank rather than sending them to multiple

presenting banks. Paying banks could return checks to the depository bank or to a bank agreeing to process returns, including the Federal Reserve. If the paying bank cannot identify the depository bank from the indorsement, it may find it necessary to send that returned check back to the presenting bank. The Federal Reserve would accept returned checks from all paying banks and explicitly charge for this service. Other returning banks are likely to establish similar services.

3. Paying banks will have the option to prepare a returned check for automated processing by high-speed equipment. This option will be used only when the paying bank is sending the returned check to a returning bank. The bank can produce a "qualified returned check" (QRC) by enclosing a returned check in a carrier envelope or attaching a strip to the bottom of the check, and encoding the carrier or strip with the nine-digit routing number of the depository bank, a special returned check identifier, and the amount of the check. By creating QRCs, the paying bank facilitates expeditious return of the check to the depository bank. Preparation of QRCs by paying banks also

reduces the cost of the overall return process because returning banks will be able to handle these checks more efficiently. To encourage paying banks to prepare QRCs, the Federal Reserve will provide later deposit deadlines at lower prices for QRCs than for returned checks that are not qualified. The Board believes that correspondent banks will adopt a similar strategy.

4. Paying banks will be required to provide notice of nonpayment on all returned checks of \$2,500 or more, regardless of the channel of collection, at an earlier time than required today. Notices will have to be received by the depositary bank by 4:00 p.m. (local time) on the second business day following presentment of a check to the paying bank. This means that if a decision is made to return a check of \$2,500 or more that was presented on Monday, the paying bank must ensure that the notice is received by the depositary bank no later than 4:00 p.m. Wednesday. The Federal Reserve will provide timely notice to the depositary bank provided that the message is originated by Fedwire by noon on the due date or that the physical returned check or a telephone message is given to the Federal Reserve by 9:00 a.m. on the due date.



Returning Banks, Including Federal Reserve Banks

Current. Returning banks currently receive returned checks from paying banks and from other returning banks, and subsequently send those returned checks to depository banks and to other returning banks. Banks that act as collecting banks during the forward collection process also act as returning banks during the return process. Generally, a returning bank receives a returned check from the bank to which it sent the check for collection or payment. The returning bank then sends the returned check to its prior indorser. In sending the returns to its prior indorser, returning banks are under a duty similar to the duty applicable to paying banks to dispatch returned checks by the midnight deadline. One of the advantages to the practice of returning through the indorsement chain is that parties in the return process have established account relationships that were used during the forward collection process. The payment for the returned check is typically a reversal of the payment made during the forward collection process.

The Federal Reserve functions as a returning bank in the current return process only for checks that it handled in the forward collection process. The Federal Reserve receives returned checks from paying banks and sends them to depository banks and other returning banks. Approximately 43 percent of the returns currently handled by the Federal Reserve are sent to

correspondent banks acting as returning banks. In some Federal Reserve regions, where correspondent banking is particularly active, the Federal Reserve office currently sends well over 50 percent of the returns it handles to correspondents in their role as returning banks.

New return rules. Under the regulation, returning banks will be held to a standard similar to paying banks. That is, returning banks must handle returned checks in an "expeditious manner," i.e., returned checks must be processed and dispatched in the same general manner as forward collection checks or returned to the depository bank within the two day/four day time period established for paying banks. This means that returning banks must process returned checks in a much shorter time frame than is typical today.

Federal Reserve Banks will establish new deposit deadlines for returned checks that closely parallel those for forward collection checks. It is expected that other returning banks will also establish new deposit deadlines for returned checks. While these deadlines need not be the same as for checks received for forward collection, returning banks may wish to establish these deadlines so as to permit paying or other returning banks to send returned checks to them on the same courier as forward collection checks. Returning banks may return a check directly to the depository bank or to another returning banks as long as the route chosen for the return is expeditious.

Returning banks would have the option, but not be required, to convert returns to QRCs. If a returning bank chooses to prepare a QRC, it may take a day to do so beyond the time when the check would otherwise have been dispatched. An extra day is not available when returning directly to the depository bank, because preparation of a QRC would not speed the return of such checks.

It is anticipated that one of the most significant changes in the return processing system for non-Federal Reserve returning banks will be the effect of the Federal Reserve's direct return policy. Federal Reserve offices will no longer send returned checks to other non-Federal Reserve returning banks. This potential shift in volume (about 43 percent of current Federal Reserve return volume) could significantly reduce the number of returned checks that are handled by these returning banks.

#### The Depository Bank

Current. The depository bank receives returned checks from both paying and returning banks. Generally, a returned check is received from the bank used by the depository bank for forward collection. Depository banks also receive notices of nonpayment on checks of \$2,500 or more collected through the Federal Reserve.

New return rules. The depository bank's requirement to place a standard indorsement on the check is critical to improvements in the return process. By following the new indorsement standard and imprinting a complete, legible indorsement on the check, the depository bank will greatly assist paying and returning banks in identifying the depository bank and, therefore, in processing the return promptly. To comply with the standard, most depository banks will need to replace their current indorsement plates. Some banks may want to work with corporate customers that encode checks prior to deposit to have the corporate customer place the depository bank's indorsement on the check according to the new standard. Some small depository banks may want to arrange with their correspondent to have the correspondent place its indorsement on the check as the depository bank endorsement. Failure to follow the indorsement standard may increase the risk of loss to the depository bank because paying and returning banks may be relieved of liability for delay in return if the delay is due to a nonstandard indorsement.

Depository banks may receive returns from returning banks with which the depository bank currently does not have a forward check collection relationship. Many depository banks will, for the first time, begin receiving returned checks directly from the Federal Reserve. If the depository bank

requests courier delivery of its returned checks at a location where the Federal Reserve does not currently provide courier service, the depository bank may be charged for the transportation.

Some depository banks that currently are charged by a returning bank for returned checks will begin receiving returned checks without a per item charge. Depository banks must pay, in same-day funds, for returned checks on the day the checks are received. If paying banks and returning banks that return checks directly do not wish to receive same-day payment by wire transfer, cash, or Federal Reserve net settlement, or if the paying or returning bank does not maintain an account relationship with the depository bank, the banks may agree as to the form of payment. The form of payment may be a check or an ACH payment.

Depository banks that have an electronic connection with the Federal Reserve with funds transfer capability will have to receive notices of nonpayment electronically after January 1, 1989.

Under the new check return rules, depository banks will receive returned checks and notices of nonpayment earlier than they do today, and will receive notices of nonpayment on all large-dollar returned checks, instead of only those checks which were collected through the Federal Reserve.

Future regulatory initiatives. The rules contained in Subpart C of the regulation will significantly improve the check return process. Under the temporary schedule, these rules will facilitate the return of most checks before the time the depository bank must make funds available for withdrawal. A significant percentage of checks will not be returned to the depository bank before the time funds must be made available, however, under the permanent availability schedule, which takes effect in 1990. The Board will review whether further modifications to the check return rules should be proposed, providing for an even more expeditious return of checks, after assessing the effect of the new requirements on the check return system.

Changes to the forward collection process are also being considered. On April 4, 1988, the Board requested public comment on whether a paying bank should be required to pay checks presented before its cut-off hour, on the day of presentment and without the imposition of presentment fees. This proposal has the potential to speed the collection of some checks. In December 1987, the Board requested comment on actions the Board should take to limit certain delayed disbursement practices. The Board will consider specific proposals to limit the delayed disbursement of "official" checks in the near future.