

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **10256**
August 23, 1988]

REGULATION CC

— Interim Rule on Definition of Paying Bank, Effective September 1

— Comment Invited by September 12

*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 approved an interim rule amending Regulation CC (Availability of Funds and Collection of Checks) to conform the definition of "paying bank" to the Expedited Funds Availability Act as interpreted by a recent court decision.

Shortly after the Board issued Regulation CC in May 1988, a trade association of credit unions and one credit union whose checks are payable through a nonlocal bank filed suit against the Board seeking to overturn the definition of paying bank.

In July 1988, the U.S. District Court for the District of Columbia ruled that the definition of paying bank in Regulation CC is inconsistent with the Act and invalid to the extent that it defines a credit union share draft payable through a bank as local or nonlocal depending on the location of the payable through bank rather than the payor credit union for purposes of the availability requirements in Regulation CC.

The Board has adopted amendments conforming to the court decision on an interim basis to ensure they are in place when the Act takes effect on September 1, 1988.

The Board also is requesting comment on the interim rule pending consideration of a longer term response to the court decision.

Comments should be received on this matter by September 12, 1988.

Printed on the following pages is the text of the amendment, as published in the *Federal Register* of August 18. Comments on the interim rule, which becomes effective September 1, 1988, should be submitted by September 12, and may be sent to the Board, as indicated in the notice, or to John F. Sobala, Vice President, Check Processing Function of this Bank.

E. GERALD CORRIGAN,
President.

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FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Docket No. R-0643]

Regulation CC; Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Interim rule with request for comments.

SUMMARY: The Board is amending Regulation CC to conform the definition of "paying bank" to the Expedited Funds Availability Act as interpreted by a recent court decision. Other conforming amendments are also being made. The Board has adopted these changes on an interim basis to ensure they are in place when the Act takes effect on September 1, 1988. The Board is requesting comments on the interim rule pending adoption of a final rule.

DATES: The interim rule takes effect on September 1, 1988.

Comments must be received no later than September 12, 1988.

ADDRESS: Comments, which should refer to Docket No. R-0643, may be mailed to the Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551, Attention: Mr. William W. Wiles, Secretary; or may be delivered to Room B-2223 between 8:45 a.m. and 5:00 p.m. All comments received will be made available to the public, and may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m.

Comments on the changes to the information collection requirements should be sent to Mr. Robert Neal, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3228, Washington, DC 20503.

FOR FURTHER INFORMATION CONTACT: Joseph R. Alexander, Senior Attorney, Legal Division (202/452-2489); Louise L. Roseman, Assistant Director, Division of Federal Reserve Bank Operations (202/452-3874); Gerald P. Hurst, Senior Counsel, Division of Consumer and Community Affairs (202/452-3667). For the hearing impaired *only*: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

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 (202/395-7340).

SUPPLEMENTARY INFORMATION: On May 13, 1988, the Board issued its Regulation CC—Availability of Funds and Collection of Checks (12 CFR Part 229) to implement the Expedited Funds Availability Act (the "Act") (Title VI of Pub. L. 100-86). 53 FR 19373 (May 27, 1988). In keeping with the Board's view that the Act established a clear link between the time it normally takes a check to be cleared and returned, and the time within which the depository bank¹ must make the funds available to the depositor, the regulations provided that where a check is payable by one bank but "payable through"² another and sent to the payable through bank for payment or collection, the location of the payable through bank would determine whether a check is local or nonlocal vis-a-vis the depository bank for the purposes of the funds availability schedules in the regulation.

Shortly after the Board issued Regulation CC, a trade association of credit unions and one credit union whose checks are payable through a nonlocal bank filed suit against the Board seeking to overturn the definition of paying bank to the extent that the definition included a payable through bank where the check was drawn on a credit union. Recently, the court granted the plaintiffs' motion for summary judgment and invalidated Regulation CC's definition of paying bank to the extent that it includes a payable through bank where the check is drawn on a credit union. *Credit Union National Association v. Board of Governors*, No. 88-1295 OG (D.D.C. July 28, 1988). The court found that the Board's regulation was inconsistent with the Act to the extent that it defined the payable through bank as the paying bank for purposes of the Act's funds availability requirements.

The Expedited Funds Availability Act takes effect on September 1, 1988. Regulation CC also takes effect on that date, except for those portions of it invalidated by the Court's order. The Board has not determined whether to appeal the court's decision.

¹ The Act uses the term "receiving depository institution" to mean "the branch of a depository institution or the proprietary ATM in which a check is first deposited." 12 U.S.C. 4001(20). Because the term "receiving depository institution" is unique to the Act, the Board used the term "depository bank," which, because it is used in the Uniform Commercial Code ("U.C.C.") and the Board's Regulation J (12 CFR Part 210), is familiar to the banking industry.

² When a check states on its face that it is "payable through" a bank, that bank is referred to as the "payable through bank." Under the U.C.C., a payable through bank is not named as the payor, but is designated as a "collecting bank to make presentment." U.C.C. 3-120. Under the Board's Regulation J, a payable through bank is the "paying bank." 12 CFR 210.2(j).

Nevertheless, in order to clarify the duties of banks and others with respect to checks in light of the court's order, temporary conforming amendments are being made to the definitions and to the disclosure rules. These amendments primarily affect the classification of checks payable by a depository institution but payable through another institution as local or nonlocal. They do not affect payable through drafts payable by nonbank payors. Further, as the payable through share draft will carry the routing number of the payable through bank, not the credit union, provisions in the regulation that allow a depository bank to rely on the routing number to determine whether a check is local or nonlocal are also being amended.

The interim rule permits depository institutions whose initial disclosures are affected by the court's decision to send simple clarifying notices in regularly scheduled mailings to existing account customers. Institutions will be deemed to be in compliance with the disclosure requirements of the regulation as long as the disclosures are revised by December 31, 1988. Finally, depository institutions may have operational difficulties in identifying credit union payable through share drafts for availability purposes. The Commentary to § 229.21(c) concerning bona fide errors is being amended to clarify that it may be a bona fide error if a depository institution fails to identify for availability purposes a local check that is a payable through draft provided that it has procedures for identifying such drafts. If the Board decides not to appeal the court's decision or if any appeal is unsuccessful, the Board, after consideration of any comments received with regard to the interim rule, may adopt the interim rule as a final amendment to Regulation CC. In addition, the Board may also consider additional rulemaking to address operational or disclosure problems that might result because depository banks and bank customers cannot rely on the routing number printed on a payable through draft to determine whether the check is local or nonlocal for funds availability purposes.

The Board believes that it is important to clarify these issues with an amended regulation before September 1, so that banks and other parties affected by Regulation CC are fully aware of their responsibilities under the Act by the time it takes effect. Nonetheless, there is not sufficient time for the Board to publish proposed regulations for comment before that date. Accordingly, the Board, for good cause, finds that the notice and public comment procedure

normally required is impractical and contrary to the public interest under 5 U.S.C. 553(b)(B). The Board further finds that, for the same reasons, there is good cause under 5 U.S.C. 553(d)(3) to make the interim rule effective on September 1, 1988, without regard for the 30-day period provided for in 5 U.S.C. 553(d).

Paperwork Reduction Act Notice. The Board has previously submitted the disclosure requirements and model forms and clauses of Regulation CC to the Office of Management and Budget ("OMB") for clearance under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*) and OMB's Regulations for Controlling Paperwork Burdens on the Public (5 CFR Part 1320). (OMB Docket number: 7100-0234.)

The changes to Regulation CC require modifications to the disclosure requirements and two additional model forms; these are described elsewhere in this notice. These are being submitted to OMB for clearance. Additional supporting documents may be obtained from the OMB clearance officer listed above.

The Board estimates that the amended disclosure requirements will result in an increase in the one-time reporting burden of Regulation CC requirements of approximately 107,000 hours. Approximately 11,000 hours of the increase in reporting burden will be borne by state member banks and other institutions under the Board's jurisdiction.

Any comments on the collection requirements should be sent to the OMB desk officer listed above. OMB's usual practice is not to take any action on an information collection until at least 10 working days after notice in the *Federal Register*, but occasionally the public interest requires more rapid action.

List of Subjects in 12 CFR Part 229

Banks, Banking, Federal Reserve System.

For the reasons set out in the preamble, effective September 1, 1988, Title 12, Chapter II, Part 229 of the Code of Federal Regulations is amended as follows:

PART 229—AVAILABILITY OF FUNDS AND COLLECTION OF CHECKS

1. The authority citation for Part 229 continues to read as follows:

Authority: Title VI of Pub. L. 100-86, 101 Stat. 552, 635; 12 U.S.C. 4001 *et seq.*

2. In § 229.2, paragraphs (r), (s), (z), and (dd) are revised to read as follows:

§ 229.2 Definitions.

* * * * *

(r) "Local check" means a check payable by or at a local paying bank, or a check payable by a nonbank payor and payable through a local paying bank.

(s) "Local paying bank" means a paying bank that is located in the same check processing region as the physical location of—

(1) The branch or proprietary ATM of the depository bank in which that check was deposited; or

(2) Both the branch of the depository bank at which the account is held and the nonproprietary ATM at which the check is deposited.

* * * * *

(z) "Paying bank" means—

(1) The bank by which a check is payable, unless the check is payable at another bank and is sent to the other bank for payment or collection;

(2) The bank at which a check is payable and to which it is sent for payment or collection;

(3) The Federal Reserve Bank or Federal Home Loan Bank by which a check is payable;

(4) The bank through which a check is payable and to which it is sent for payment or collection, if the check is not payable by a bank;

(5) The state or unit of general local government by which a check is payable.

For purposes of Subpart C, and in connection therewith, Subpart A, "paying bank" includes the bank through which a check is payable and to which the check is sent for payment or collection, regardless of whether the check is payable by another bank, and the bank whose routing number appears on a check in fractional or magnetic form and to which the check is sent for payment or collection.

* * * * *

(dd) "Routing number" means—

(1) The number printed on the face of a check in fractional form or in nine-digit form; or

(2) The number in a bank's indorsement in fractional or nine-digit form.

* * * * *

§ 229.16 [Amended]

3. Section 229.16(b)(2) is amended by adding footnote 1 to the end of that paragraph, to read as follows:

¹ No later than December 31, 1988, a bank that distinguishes in its disclosure between local and nonlocal checks based on the routing number on the check must disclose that certain checks, such as some credit union share drafts that are payable by one bank but payable through another bank, will be treated as local or nonlocal checks based

upon the location of the bank by which they are payable and not on the basis of the location of the bank whose routing number appears on the check. The statement concerning payable through checks must describe how the customer can determine whether these checks will be treated as local or nonlocal, or state that special rules apply to such checks and that the customer may ask about the availability of these checks. The statement may be in the form of an attachment or insert to the bank's existing specific policy disclosures. In addition, banks subject to this disclosure requirement must provide a similar notice concerning the payable through checks to existing account customers no later than December 31, 1988. (Even though a bank need not make a disclosure concerning payable through checks until December 31, 1988, the bank must characterize these checks correctly as local or nonlocal checks under amended § 229.2, and provide availability in accordance with §§ 229.11, 229.12, and 229.13, effective September 1, 1988.)

4. In § 229.30, paragraph (a)(1) is revised to read as follows:

§ 229.30 Paying bank's responsibility for return of checks.

(a) * * *

(1) *Two-day/four-day test.* A paying bank returns a check in an expeditious manner if it sends the returned check in a manner such that the check would normally be received by the depository bank not later than 4:00 p.m. (local time of the depository bank) of—

(i) The second business day following the banking day on which the check was presented to the paying bank, if the paying bank is located in the same check processing region as the depository bank; or

(ii) The fourth business day following the banking day on which the check was presented to the paying bank, if the paying bank is not located in the same check processing region as the depository bank.

If the last business day on which the paying bank may deliver a returned check to the depository bank is not a banking day for the depository bank, the paying bank meets the two-day/four-day test if the returned check is received by the depository bank on or before the depository bank's next banking day.

* * * * *

5. In § 229.31, paragraph (a)(1) is revised to read as follows:

§ 229.31 Returning bank's responsibility for return of checks.

(a) * * *

(1) *Two-day/four-day test.* A returning bank returns a check in an expeditious manner if it sends the returned check in a manner such that the check would

normally be received by the depository bank not later than 4:00 p.m. (local time) of—

(i) The second business day following the banking day on which the check was presented to the paying bank if the paying bank is located in the same check processing region as the depository bank; or

(ii) The fourth business day following the banking day on which the check was presented to the paying bank if the paying bank is not located in the same check processing region as the depository bank.

If the last business day on which the returning bank may deliver a returned check to the depository bank is not a banking day for the depository bank, the returning bank meets this requirement if the returned check is received by the depository bank on or before the depository bank's next banking day.

6. The heading and the first two introductory paragraphs of Appendix A to Part 229 are revised and the third introductory paragraph is removed to read as follows:

Appendix A—Routing Number Guide to Next-Day Availability Checks and Local Checks

Each bank is assigned a routing number by Rank McNally & Co., as agent for the American Bankers Association. The routing number takes two forms: A fractional form and a nine-digit form. A paying bank is generally identified on the face of a check by its routing number in both the fractional form (which generally appears in the upper right-hand corner of the check) and the nine-digit form (which is printed in magnetic ink in a strip along the bottom of the check). Where a check is payable by one bank but payable through another bank, the routing number appearing on the check is that of the payable through bank, not the payor bank.

The first four digits on the nine-digit routing number and the denominator of the fractional routing number form the "Federal Reserve routing symbol," which identifies the Federal Reserve District, the Federal Reserve office, and the clearing arrangements used by the paying bank.

7. Appendix C to Part 229 is amended by adding Models C-19 and C-19A to the end of the appendix to read as follows:

Appendix C—Model Forms, Clauses, and Notices

Model C-19—Payable through checks

In some instances we will treat checks as local or nonlocal based upon the location of the bank by which the check is payable, not on the routing number on the bottom of the check. For example, if a credit union share

draft is payable by a credit union that is located in the same check processing region as our bank, the share draft will be treated as a local check, even if the draft is payable through a bank that is located outside of our check processing region as determined by the routing number on the check. If you have any questions about a specific check, please ask your branch manager.

Model C-19A—Payable through checks

Checks that are payable by one bank but are payable through another bank, such as credit union share drafts that are payable through a bank, are considered local or nonlocal based upon the location of the bank by which the check is payable, not the payable through bank whose routing number appears on the check. If the bank by which the payable through check is payable (the credit union in the case of a payable through credit union share draft) is located in the same check processing region as we are, the check will be considered a local check. ((Our check processing region includes * * *) or (A map of our check processing region is (attached) (available upon request).)) If you would like to know whether a particular check falls into this category, you may ask your branch manager for assistance.

Appendix E—[Amended]

8. Appendix E—Commentary to Part 229 is amended as follows:

a. The commentary on § 229.2 (o), (r), (s), and (z) is revised to read as follows:

Section 229.2 Definitions

(o) *Depository bank.* The regulation uses the term depository bank rather than the term "receiving depository institution." "Receiving depository institution" is a term unique to the Act, while "depository bank" is the term used in Article 4 of the U.C.C. and Regulation J.

A depository bank includes the bank in which the check is first deposited. If a foreign office of a U.S. or foreign bank sends checks to its U.S. correspondent bank for forward collection, the U.S. correspondent is the depository bank since foreign offices of banks are not included in the definition of bank.

If a customer deposits a check in its account at a bank, the customer's bank is the depository bank with respect to the check. For example, if a person deposits a check into an account at a nonproprietary ATM, the bank holding the account into which the check is deposited is the depository bank even though another bank may service the nonproprietary ATM and send the check for collection. (Under § 229.35 the depository bank may agree with the bank servicing the nonproprietary ATM to have the servicing bank place its own indorsement on the check as the depository bank. For the purposes of Subpart C, the bank applying its indorsement as the depository bank indorsement on the check is the depository bank.)

For purposes of Subpart B, a bank may act as both the depository bank and the paying bank with respect to a check, if the check is payable by the bank in which it was deposited, or if the check is payable by a nonbank payor and payable through or at the bank in which it was deposited. A bank is

also considered a depository bank with respect to checks it receives as payee. For example, a bank is a depository bank with respect to checks it receives for loan repayment, even though these checks are not deposited in an account at the bank. Because these checks would not be "deposited to accounts," they would not be subject to the availability or disclosure requirements of Subpart B.

(r) *Local check* is defined as a check payable by or at a local paying bank, or, in the case of nonbank payors, payable through a local paying bank. A check payable by a local bank but payable through a nonlocal bank is a local check. Conversely, a check payable through a local bank but payable by a nonlocal bank is a nonlocal check. Where two banks are named on a check and neither is designated as a payable through bank, the check is considered payable by either bank and may be considered local or nonlocal depending on which bank it is sent to for payment. Generally, the depository bank may rely on the routing number to determine whether a check is local or nonlocal.

Appendix A includes a list of routing numbers arranged by Federal Reserve Bank Office to assist persons in determining whether or not such a check is local. If, however, a check is payable by one bank but payable through another bank, the routing number appearing on the check will be that of the payable through bank, not the paying bank. Many credit union share drafts and certain other checks payable by banks are payable through other banks. In such cases, the routing number cannot be relied on to determine whether the check is local or nonlocal. In a few cases, a payable through bank will be designated only by routing numbers and will not be named on the check. In such cases also, the routing number may not be relied on to determine whether the check is local or nonlocal.

(s) *Local paying bank* is defined as a paying bank located in the same check processing region as the branch or proprietary ATM of the depository bank.

Examples

1. If a check that is payable by a bank that is located in the same check processing region as the depository bank is payable through a bank located in another check processing region, the check is considered local or nonlocal depending on the location of the bank by which it is payable even if the check is sent to the nonlocal bank for collection.

2. The location of the depository bank is determined by the physical location of the branch or proprietary ATM at which a check is deposited. If the branch of the depository bank located in one check processing region sends a check to the depository bank's central facility in another check processing region, and the central facility is in the same check processing region as the paying bank, the check is still considered nonlocal. (See Commentary on definition of "paying bank".)

For deposits at nonproprietary ATMs, a paying bank is a local paying bank only if the paying bank is located in the same check processing region as the location of both the branch of the depository bank at which the

account is held and the nonproprietary ATM at which the check is deposited.

(z) *Paying bank.* The regulation uses this term in lieu of the Act's "originating depository institution." For purposes of Subpart B, the term "paying bank" includes the payor bank, the payable at bank to which a check is sent, or, if the check is payable by a nonbank payor, the bank through which the check is payable and to which it is sent for payment or collection. For purposes of Subpart C, the term includes the payable through bank and the bank whose routing number appears on the check regardless of whether the check is payable by a different bank, provided that the check is sent for payment or collection to the payable through bank or the bank whose routing number appears on the check.

Under §§ 229.30 and 229.36(a), a bank designated as a "payable through bank" or "payable at bank" and to which the check is sent for payment or collection is responsible for the expedited return of checks and notice of nonpayment requirements of Subpart C. The payable through or payable at bank may contract with the payor with respect to its liability in discharging these responsibilities. The Board believes that the Act makes a clear connection between availability and the time it takes for checks to be cleared and returned. Allowing the payable through bank additional time to forward checks to the payor and await return or pay instructions from the payor would delay the return of these checks, increasing the risks to depository banks. Subpart C places on payable through and payable at banks the requirements of expeditious return based on the time the payable through or payable at bank received the check for forward collection.

If a check is sent for forward collection based on the routing number, the bank associated with the routing number is a paying bank for the purposes of Subpart C requirements, including notice of nonpayment, even if the check is not drawn by a customer of that bank or the check is fraudulent.

The phrase "and to which [the check] is sent for payment or collection" includes sending not only the physical check, but information regarding the check under a truncation arrangement.

Federal Reserve Banks and Federal Home Loan Banks are also paying banks under all subparts of the regulation with respect to checks payable by them, even though such banks are not defined as banks for purposes of Subpart B.

b. The Commentary on § 229.11(c) is amended by adding a paragraph at the end immediately preceding (d) to read as follows:

Section 229.11 Temporary Availability Schedule

(c) * * *

A reduction in schedules may apply even in those cases where the determination that the check is nonlocal cannot be made based on the routing number on the check. For example, a nonlocal credit union payable

through share draft may be subject to a reduction in schedules if the routing number of the payable through bank which appears on the draft is included in Appendix B, even though the determination that the payable through share draft is nonlocal is based on the location of the credit union and not the routing number on the draft.

c. The Commentary on § 229.21(c) is amended by removing the period at the end of the paragraph and adding the following language:

Section 229.21 Civil liability

(c) * * *
; or if it fails to identify whether a payable through check is a local or nonlocal check despite procedures designed to make this determination accurately.

d. The Commentary on § 229.30 is amended by revising the introductory paragraphs of (a) and the complete text of (a)(1) to read as follows:

Section 229.30 Paying Bank's Responsibility for Return of Checks

(a) *Return of checks.* This section requires a paying bank (which, for purposes of Subpart C, may include a payable through and payable at bank; see § 229.2(z)) that determines not to pay a check to return the check expeditiously. Generally, a check is returned expeditiously if the return process is as fast as the forward collection process. This paragraph provides two standards for expeditious return, the "two-day/four-day" test, and the "forward collection" test.

Under the "two-day/four-day" test, if a check is returned such that it would normally be received by the depository bank two business days after presentment where both the paying and depository banks are located in the same check processing region or four business days after presentment where the paying and depository banks are not located in the same check processing region, the check is considered returned expeditiously. In certain limited cases, however, these times are shorter than the time it would normally take a forward collection check deposited in the paying bank and payable by the depository bank to be collected. Therefore, the Board has included a "forward collection" test, whereby a check is nonetheless considered to be returned expeditiously if the paying bank uses transportation methods and banks for return comparable to those used for forward collection checks, even if the check is not received by the depository banks within the two-day or four-day period.

(1) *Two-day/four-day test.* Under the first test, a paying bank must return the check so that the check would normally be received by the depository bank within specified times, depending on whether or not the paying and depository banks are located in the same check processing region.

Where both banks are located in the same check processing region, a check is returned expeditiously if it is returned to the

depository bank by 4:00 p.m. (local time of the depository bank) of the second business day after the banking day on which the check was presented to the paying bank. For example, a check presented on Monday to a paying bank must be returned to a depository bank located in the same check processing region by 4:00 p.m. on Wednesday. For a paying bank that is located in a different check processing region than the depository bank, the deadline to complete return is 4:00 p.m. (local time of the depository bank) of the fourth business day after the banking day on which the check was presented to the paying bank. For example, a check presented to such a paying bank on Monday must be returned to the depository bank by 4:00 p.m. on Friday.

This two-day/four-day test does not necessarily require actual receipt of the check by the depository bank within these times. Rather, the paying bank must send the check so that the check would normally be received by the depository bank within the specified time. Thus, the paying bank is not responsible for unforeseeable delays in the return of the check, such as transportation delays.

Often, returned checks will be delivered to the depository bank together with forward collection checks. Where the last day on which a check could be delivered to a depository bank under this two-day/four-day test is not a banking day for the depository bank, a returning bank might not schedule delivery of forward collection checks to the depository bank on that day. Further, the depository bank may not process checks on that day. Consequently, if the last day of the time limit is not a banking day for the depository bank, the check may be delivered to the depository bank before the close of the depository bank's next banking day and the return will still be considered expeditious. Ordinarily, this extension of time will allow the returned checks to be delivered with the next shipment of forward collection checks destined for the depository bank.

The times specified in this two-day/four-day test are based on estimated forward collection times, but take into account the particular difficulties that may be encountered in handling returned checks. It is anticipated that the normal process for forward collection of a check coupled with these return requirements will frequently result in the return of checks before the proceeds of local and nonlocal checks, other than those covered by § 229.10(c), must be made available for withdrawal under the temporary schedules in § 229.11.

Under this two-day/four-day test, no particular means of returning checks is required, thus providing flexibility to paying banks in selecting means of return. The Board anticipates that paying banks will often use returning banks (see § 229.31) as their agents to return checks to depository banks. A paying bank may rely on the availability schedule of the returning bank it uses in determining whether the returned check would "normally" be returned within the required time under this two-day/four-day test, unless the paying bank has reason to believe that these schedules do not reflect the actual time for return of a check.

e. The Commentary on § 229.31(a) is amended by revising the paragraphs up to the examples to read as follows:

Section 229.31 Returning Bank's Responsibility for Return of Checks

(a) *Return of checks.* The standards for return of checks established by this section are similar to those for paying banks in § 229.30(a). This section requires a returning bank to return a returned check expeditiously if it agrees to handle the returned check for expeditious return under this paragraph. In effect, the returning bank is an agent or subagent of the paying bank and a subagent of the depository bank for the purposes of returning the check. A returning bank agrees to handle a returned check for expeditious return to the depository bank if it:

- (1) Publishes or distributes availability schedules for the return of returned checks and accepts the returned check for return;
- (2) Handles a returned check for return that it did not handle for forward collection; or
- (3) Otherwise agrees to handle a returned check for expeditious return.

As in the case of a paying bank, a returning bank's return of a returned check is expeditious if it meets either of two tests. Under the "two-day/four-day" test, the check must be returned so that it would normally be received by the depository bank by 4:00 p.m. either two or four business days after the check was presented to the paying bank, depending on whether or not the paying bank is located in the same check processing region as the depository bank. This is the same test as the two-day/four-day test applicable to paying banks. (See Commentary to § 229.30(a).) While a returning bank will not have first hand knowledge of the day on which a check was presented to the paying bank, returning banks may, by agreement, allocate with paying banks liability for late return based on the delays caused by each. In effect, the two-day/four day test protects all paying and returning banks that return checks from claims that they failed to return a check expeditiously, where the check is returned within the specified time following presentation to the paying bank, or a later time as would result from unforeseen delays.

The "forward collection" test is similar to the forward collection test for paying banks. Under this test, a returning bank must handle a returned check in the same manner that a similarly situated collecting bank would handle a check of similar size drawn on the depository bank for forward collection. A similar situated bank is a bank (other than a Federal Reserve Bank) that is of similar asset size and check handling activity in the same community. A bank has similar check handling activity if it handles a similar volume of checks for forward collection as the forward collection volume of the returning bank.

Under the forward collection tests, a returning bank must accept returned checks, including both qualified and other returned checks ("raw returns"), at approximately the same times and process them according to the same general schedules as checks handled for forward collection. Thus, a returning bank generally must process even raw returns on an overnight basis, unless its

time limit is extended by one day to convert a raw return to a qualified returned check.

A returning bank may establish earlier cut-off hours for receipt of returned checks than for receipt of forward collection checks, but the cut-off hour for returned checks may not be earlier than 2:00 p.m. The returning bank also may set different sorting requirements for returned checks than those applicable to other checks. Thus, a returning bank may allow itself more processing time for returns than for forward collection checks. All returned checks received by a cut-off hour for returned checks must be processed and dispatched by the returning bank by the time that it would dispatch forward collection checks received at a corresponding forward collection cut-off hour that provides for the same or faster availability for checks destined for the same depository banks.

* * * * *
f. The Commentary on § 229.36 is amended by revising the complete text of (a) and (b) to read as follows:

Section 229.36 Presentment of Checks

(a) *Payable through and payable at checks.* For purposes of Subpart C, the regulation defines a payable through or payable at bank (which could be designated the collectible through or collectible at bank) as a paying bank. The requirements of § 229.30(a) and the notice of nonpayment requirements of § 229.33, are imposed on a payable through or payable at bank and are based on the time of receipt of the forward collection check by the payable through or payable at bank. This provision is intended to speed the return of checks that are payable through or at a bank to the depository bank.

(b) *Receipt at bank office or processing center.* This paragraph seeks to facilitate efficient presentment of checks to promote early return or notice of nonpayment to the depository bank, and clarifies the law as to the effect of presentment by routing number. This paragraph differs from § 229.39(b) because presentment of checks differs from delivery of returned checks.

The paragraph specifies four locations at which the paying bank must accept presentment of checks. Where the check is payable through a bank and the check is sent to that bank, the payable through bank is the paying bank for purposes of this subpart, regardless of whether the paying bank must present the check to another bank or to a nonbank payor for payment.

1. Delivery of checks may be made, and presentment is considered to occur, at a location (including a processing center) requested by the paying bank. This is the way most checks are presented by banks today. This provision adopts the common law rule of a number of legal decisions that the processing center acts as the agent of the paying bank to accept presentment and to begin the time for processing of the check. (See also U.C.C. 4-204(3).) If a bank designates different locations for the presentment of forward collection checks bearing different routing numbers, for purposes of this paragraph it only requests presentment of checks bearing a particular routing number at the location designated for receipt of forward collection checks bearing that routing number.

2. Delivery may be made at an office of the bank associated with the routing number on the check. The office associated with the routing number of a bank is found in a publication of Rand McNally, *Key to Routing Numbers*, which lists a city and state address for each routing number. Checks are generally handled by collecting banks on the basis of the nine-digit routing number encoded in magnetic ink (or on the basis of the fractional form routing number if the magnetic ink characters are obliterated) on the check, rather than the printed name or address. The definition of a paying bank in § 229.2(z) includes a bank designated by routing number, whether or not there is a name on the check, and whether or not any name is consistent with the routing number. Where a check is payable by one bank, but payable through another, the routing number is that of the payable through bank, not that of the payor bank. As the payor bank has selected the payable through bank as the point through which presentment is to be made, it is proper to treat the payable through bank as the paying bank for purposes of this section.

There is no requirement in the regulation that the name and address on the check agree with the address associated with the routing number on the check. A bank may generally control the use of its routing number, just as it does the use of its name. The address associated with the routing number may be a processing center.

In some cases, a paying bank may have several offices in the city associated with the routing number. In such case, it would not be reasonable or efficient to require the presenting bank to sort the checks by more specific branch addresses that might be printed on the checks, and to deliver the checks to each branch. A collecting bank would normally deliver all checks to one location. In cases where checks are delivered to a branch other than the branch on which they may be drawn, computer and courier communication among branches should permit the paying bank to determine quickly whether to pay the check.

3. If the check specifies the name of the paying bank but no address, the bank must accept delivery at any office. Where delivery is made by a person other than a bank, or where the routing number is not readable, delivery will be made based on the name and address of the paying bank on the check. If there is no address, delivery may be made at any office of the paying bank. This provision is consistent with U.C.C. 3-504(2), which states that presentment for payment may be made at the place specified in the instrument, or, if there is none, at the place of business of the party to pay. Thus, there is a trade-off for a paying bank between specifying a particular address on a check to limit locations of delivery, and simply stating the name of the bank to encourage wider currency for the check.

4. If the check specifies the name and address of a branch or head office, or other location (such as a processing center), the check may be delivered by delivery to that office or other location. If the address is too general to identify a particular office, delivery may be made at any office

consistent with the address. For example, if the address is "San Francisco, California," each office in San Francisco must accept presentment. The designation of an address on the check is generally in the control of the paying bank.

This paragraph may affect U.C.C. 3-504(2)(c) to the extent that the U.C.C. requires presentment to occur at a place specified in the instrument.

* * * * *

g. The Commentary on Appendix C to Part 229 is amended as follows:

(1) Add a paragraph at the end of the text titled "*Models C-1 through C-7 generally*" and before the text beginning with "*Model C-1*".

(2) Add Commentary on Models C-19 and C-19A to the end of the appendix.

Appendix C—Model Forms, Clauses, and Notices

* * * * *

Models C-1 through C-7 generally. * * *

In addition, a bank that distinguishes in its disclosure between local and nonlocal checks based on the routing number on the check (as set forth in model forms C-4 through C-7) must disclose that certain checks, such as credit union share drafts that are payable through a bank, will be treated as local or nonlocal based upon the location of the payor bank and not on the basis of the routing number on the check. Model C-19 or C-19A could be incorporated into model forms C-4 through C-7 to meet this requirement.

* * * * *

Model C-19 and C-19A. Either of these statements satisfies the requirements set

forth in the footnote to § 229.16(b)(2) concerning payable through checks. The statements are both model clauses and notices in that they may be added to a bank's specific policy disclosure to describe how the bank treats payable through checks, and may be used as the notice that must be sent to existing customers no later than December 31, 1988, if the bank's specific policy disclosure given to the customers did not accurately reflect the treatment of payable through checks.

By order of the Board of Governors of the Federal Reserve System, August 12, 1988.

William W. Wiles,

Secretary of the Board

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Special Notice

Board of Governors of the Federal Reserve System • Washington, DC 20551

Regulation CC - Expedited Funds Availability How the Indorsement Standard Affects Depository Institutions and Their Customers

August 1988

TO: Member Banks of the Federal Reserve System
and other Depository Institutions

FROM: Board of Governors of the Federal Reserve System

SUBJECT: Compliance with the Indorsement Standard Contained
in Regulation CC

In May 1988, the Federal Reserve Board issued Regulation CC to implement the Expedited Funds Availability Act. The regulation contains a standard that is to be used by depository institutions in indorsing checks starting on September 1, 1988.

There appears to be a great deal of confusion about the consequences of not indorsing checks in accordance with the standard. It has been reported that institutions have informed established customers that they will not accept for deposit a check simply because the check was not indorsed properly and that institutions are instructing their customers to discontinue using checks containing carbon bands. It has also been reported that some institutions are requesting customers to sign indemnification agreements, and others are planning to assess special fees when customers do not follow these instructions.

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We understand that institutions are taking these steps because the institutions believe that these steps will reduce the potential risk associated with an unpaid check being returned untimely. Many of the above actions appear to be unnecessary considering the small additional risk faced by depository institutions in handling a check that is "improperly" indorsed or contains a carbon band. The regulation does not impose any civil penalty for failure to comply with the indorsement standard. Failure to comply primarily means that the depository institution is not taking advantage of the standard to expedite the return of checks. The expeditious return and the indorsement standard reduce the risks to depository institutions.

The purpose of the standard, which affects all depository institutions and their customers, is to make it easier to identify the depository institution into which the check was first deposited. By making it easier to identify the depository institution where the check was first deposited, checks that are being returned unpaid (for example, due to insufficient funds) will get back to that depository institution faster than is possible today. More expeditious return reduces the likelihood that the depository institution and/or its customer will suffer financial losses because a check is returned unpaid. Depository institutions are required by Regulation CC to use new procedures designed to return checks expeditiously, and the indorsements that make it easy to identify the depository institution where the check was first deposited are important to the success of these new procedures.

This indorsement standard goes into effect on September 1, 1988, in conjunction with the other requirements of Regulation CC. (For further information about the other requirements of Regulation CC, see Regulation CC issued in May 1988, and the Special Notice issued by the Board in June 1988.) Because of the relatively short time period between publishing the indorsement standard in April 1988 and the effective date of September 1, 1988, the Federal Reserve realizes that many depository institutions may not be able to comply with the standard immediately because the depository institution may need to modify equipment. In some cases, these changes cannot be made in a cost effective manner by September 1, 1988. Other efforts to make indorsements easier to read, such as changing consumer and retail indorsements are longer-term initiatives.

The attached notice discusses the indorsement standard and its impact on depository institutions and their customers. It also discusses the consequences of failure to adhere to the standard.

If you need further assistance or information, contact your local Federal Reserve Bank or the Federal Reserve Board.



Regulation CC - Indorsement Standards

Why are checks indorsed and why does Regulation CC impose a standard for indorsing checks?

Checks are indorsed in order to transfer rights to obtain payment for the check. Payees often indorse checks to the bank¹ in which the payee deposits the check. Banks also indorse each check as the check is transferred from bank to bank in the course of presenting the check to the paying bank in order to obtain payment.

Currently, there are no standards with regard to how such indorsements should be applied to the back of the check. As a result, many times the indorsements are faint, blurred, incomplete and overlapping, making the indorsement difficult, if not impossible, to read. This difficulty in reading indorsements is a major hindrance in returning unpaid checks to the depository bank promptly.

The indorsement standard established by Regulation CC specifies the locations on the back of the check for bank indorsements, requires bank indorsements to contain certain information, and specifies the colors of ink for bank indorsements. **THE STANDARD DOES NOT IMPOSE SPECIFIC REQUIREMENTS ON PAYEE INDORSEMENTS OR ON BANK CUSTOMERS ISSUING CHECKS. FURTHER, THERE ARE NO PENALTIES FOR FAILURE TO MEET THE INDORSEMENT STANDARDS. NEVERTHELESS, IT IS IN THE INTERESTS OF BOTH BANKS AND THEIR CUSTOMERS TO ENSURE THAT CHECKS ARE CLEARLY AND PROPERLY INDORSED.**

¹Regulation CC defines "bank" to include commercial banks, savings banks, savings and loan institutions, and credit unions; "depository bank" as the bank where the check is first deposited; and "paying bank" as the bank on which the check is written.

The Depository Bank and Its Customer

The indorsement standard requires the depository bank to place its indorsement in a specific location on the back of the check, to include certain information in its indorsement, and to use either black or purple ink to apply its indorsement. Other banks may not indorse in the location specified for the depository bank indorsement. These requirements should make it easier for paying or returning banks to identify the depository bank and return an unpaid check or provide notice of nonpayment directly to the depository bank.

Making it easier for paying or returning banks to identify the depository bank will benefit both the depository bank and its customer. New expeditious return procedures established by Regulation CC are designed to get returned checks back to the depository bank and its customers more quickly than is the case today. Giving a depository bank and its customer greater assurance that it will learn of a returned check in a shorter time period than it can today will decrease the likelihood that one of them will suffer a loss in connection with a returned check.

Prompt return of checks is particularly important to bank customers. Although banks can generally charge checks back to their customers' accounts, a bank customer often must contact the check writer to obtain reimbursement. The sooner that a depository bank's customer can learn of a returned check, the sooner the bank's customer can begin the process of searching for the check writer to obtain payment. Generally, a depository bank's customer should have more success in recovering these funds when beginning the recovery process sooner.

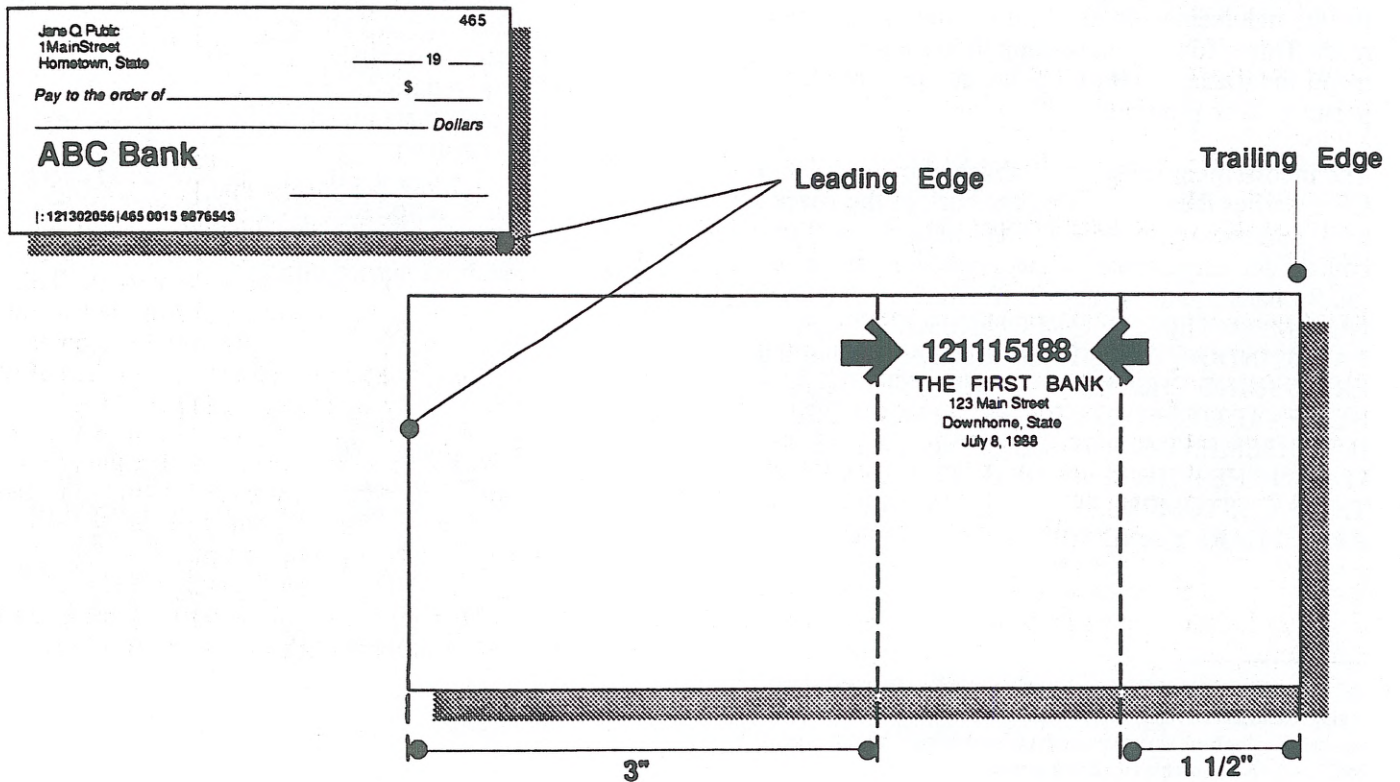


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Thus, both the depository bank and its customer will benefit when the paying or returning bank is able to identify the depository bank accurately and easily from the indorsement placed on the back of the check. Therefore, even though the indorsement standard does not specify a specific location or other requirements for payee indorsements, both the payee and the depository bank may benefit when the payee indorsement is applied outside of the location specified for the depository bank.

The depository bank indorsement is to be made in the area beginning 3.0 inches from the leading edge of the check and ending 1.5 inches from the trailing edge of the check. (See Figure 1.) The entire indorsement need not be within this area; however, the indorsement must be placed so that the nine-digit routing number of the bank (set off by arrows) is wholly contained within this area. The routing number is the principle piece of information that is needed by the

Figure 1. Indorsement Standard: Depository Bank



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paying or returning bank to identify the depository bank. To the extent that the depository bank does not want to risk having other indorsement information overstamped by other bank indorsements, that information should also be placed in the location reserved for the depository bank indorsement. However, the only piece of information that is required to be in this area is the depository bank's nine-digit routing number (set off by arrows).

If a depository bank and its customer adhere to the indorsment standard, they will not be responsible if a paying or returning bank fails to return a check timely due to an error in reading the depository bank's indorsement. This does not affect a depository bank's right to claim untimely return for violations of the paying bank's "midnight deadline" rule from the Uniform Commercial Code.

Some depository banks have informed their customers that they will not accept some checks for deposit simply because they do not indorse wholly within the payee indorsement area. However, payee indorsements may be placed anywhere on the back of the check outside of the location specified for the depository bank.

Referencing Figure 1, this means that the payee should indorse either in the area from the leading edge of the check to 3.0 inches from the leading edge or in the area from 1.5 inches from the trailing edge of the check to the trailing edge of the check. Today, most payees conventionally indorse in the 1.5 inches closest to the trailing edge of the check. It is anticipated that most payees will continue to indorse in this area, however, they are not required to do so. Indorsing in the payee area merely reduces the risk that the payee's indorsement may be obscured by other indorsements.

Depository banks are encouraged to inform their customers that the 1.5-inch area closest to the trailing edge of the check will not generally be used by depository banks and will not be used by subsequent collecting banks when applying indorsements. This means that payees receiving returned checks and relying on information contained in their indorsement about the identity of the check writer will most likely find it easier to read such information if the indorsement is placed in this area. The Federal Reserve understands, however, that many retail indorsements and other information necessary to help identify check writers may not fit into this location. Therefore, it is still acceptable for the payee indorsement to be placed in the 3-inch area closest to the leading edge of the check; however, payee indorsements in this area may be overstamped by a bank indorsement applied during the process of collecting the check (see discussion of subsequent bank indorsements below); however, this occurs today and should not present any significant problems to the payee of the check.

Some depository banks have retail customers who deposit large numbers of checks that have already been prepared for automated processing. The retail customer of the bank may apply the depository bank indorsement in addition to its own indorsement. This is perfectly acceptable under the regulation, but is not required. This could be done by the retail customer by either applying a separate indorsement on behalf of the depository bank or by incorporating the requirements of the depository bank indorsement into a joint payee/depository bank indorsement. When the retail customer applies the depository bank indorsement, the retail customer can control placement of the depository bank indorsement, thereby insuring that any payee indorsement information that might infringe into the location reserved for the depository bank does not render the depository bank indorsement unreadable.



In other cases, a smaller depository bank may desire to have its correspondent indorse as the depository bank so that its correspondent will receive all returned checks and notices of nonpayment on behalf of the depository bank. Regulation CC allows banks to make such arrangements, by agreement. In these cases, the correspondent will serve as the depository bank for purposes of Subpart C of Regulation CC. When the correspondent will be indorsing as the depository bank, the respondent bank (the actual depository bank) should not indorse as a depository bank. The regulation does not require the respondent bank to indorse the check in any particular manner in these cases. The respondent bank should indorse the check and is not prohibited from doing so either as a payee of the check or in the subsequent bank indorsement location.

The Paying Bank and Its Customer

The paying bank is not required to indorse the check by Regulation CC, however, it is not prohibited from doing so. If the paying bank indorses the check, it would benefit most by staying clear of the location specified for the depository bank because, if it decides to return a check, the paying bank and returning banks would be better able to identify the depository bank.

The paying bank's customer, while not an indorser of the check, may still be affected by the indorsement standard. Many checks are issued with markings on the reverse side of the check. These markings are applied for a variety of reasons and include preprinted information, cross-hatching applied for security to prohibit reading the check information from the reverse side or through a mailer, and carbon bands that are used to transfer information to a ledger when the check is written.

These checks are a legal, negotiable, and acceptable form of payment. The Board also recognizes, however, that depository banks may be unable to apply indorsements that would avoid such markings. Nevertheless, it is to the benefit of the depository bank to avoid these markings whenever possible so that the depository bank can be assured of receiving returns as quickly as possible. In some cases, when markings are applied to the backs of checks in a standard fashion, such as carbon bands, banks should be able to anticipate where these markings will occur and would benefit by designing indorsements such that the nine-digit routing number in the indorsement avoids such standard markings.

Responsibility for the Back of the Check

In order to assure depository banks that their rights would not be affected by accepting for deposit checks that have markings on the back or bank customer indorsements that affect the depository bank indorsement area, Regulation CC provides that the depository bank is responsible for markings on the back of a check after the issuance of a check and the paying bank is responsible for the back of a check when it is issued. In certain instances, this responsibility may affect who bears the loss for a check that is returned untimely due to inability to read the depository bank indorsement. For example, if:

1. The paying bank's customer issues a check with markings on the back and the check bounces;
2. The paying or a returning bank is unable to identify the depository bank because the markings on the check interfere with the depository bank indorsement;



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3. The returned check gets back to the depository bank later than it otherwise would have because the paying or returning bank cannot identify the depository bank;
4. The depository bank cannot charge back the return to its depositing customer's account and, therefore, experiences a loss;
5. The loss would not have occurred had the return been timely;
6. The loss is of an amount sufficient for the depository bank to file an untimely return claim; and
7. The paying bank is unable to pay the check or recover the funds from the customer that issued the check.

The paying bank would suffer a loss on the check. The likelihood that the paying bank would actually experience a loss for most customer accounts for customers that issue checks with markings on the back is relatively low because of the sequence of events that must occur before the paying bank is exposed.

Subsequent Bank Indorsements

Subsequent collecting bank indorsements must avoid the location specified for the depository bank indorsement, must provide only certain information in the indorsement, and must not use purple ink. These indorsements must include **ONLY** the nine-digit routing number (without arrows), the indorsement date, and an optional trace/sequence number.

The abbreviated information content of the subsequent bank indorsement is another indicator that that indorsement is not that of the depository bank. In addition, the reduction in information contained in subsequent bank indorsements will assist in the readability of multiple indorsements (possibly including the payee indorsement, see discussion above) applied in that location.

Returning Bank Indorsements

The indorsement standard for returning banks is less strict than that for depository and subsequent banks. There are no information content or color requirements for returning bank indorsements. Specifically, returning banks are required to stay clear of the area from 3.0 inches from the leading edge of the check to the trailing edge of the check. This requirement will protect the location specified for the depository bank location as well as the area commonly used, but not required, for payee indorsements.

