

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **10269**
November 21, 1988]

REGULATION CC

- Final Amendment Regarding the Definition of Paying Bank**
- Proposed Amendments; Comment Invited by December 30, 1988**
- Final and Proposed Preemption Determinations**

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

Our Circular No. 10256, dated August 23, 1988, announced the adoption by the Board of Governors of the Federal Reserve System of an interim rule to conform the definition of "paying bank" in Regulation CC to a recent court decision under the Expedited Funds Availability Act. The Board of Governors has now adopted that rule as final (with some minor technical changes), and has requested comment on several proposed amendments to Regulation CC. The Board has also issued final and proposed preemption determinations under Regulation CC with regard to the State laws of New York, New Jersey, and Connecticut (among others).

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

The Federal Reserve Board has issued a final ruling under the Expedited Funds Availability Act stating that "payable through" checks must be treated as local or nonlocal based on the location of the institution on which they are written rather than the "payable through" bank.

This action finalized an interim amendment that was adopted by the Board in August in response to a court order.

At the same time, the Board published for public comment four proposals that are designed to help ease the operational difficulties and lessen the risks imposed on depository institutions as a result of the court's order. Comment on the proposals is requested by December 30, 1988. The proposals would:

- require bank payable through checks to bear a local routing number in the MICR line and to have a local presentment point;
- require such checks to be conspicuously labeled as payable through checks and to contain specified information;
- allow these checks to be presented directly to the bank on which they are written; and
- reallocate the risk of loss where the checks are payable through a nonlocal bank.

In addition, the Board requested comment by December 30 on other amendments to Regulation CC that would clarify various provisions of the regulation and help depository institutions to understand and comply with the regulation.

(OVER)

Enclosed — for depository institutions in the Second Federal Reserve District — is the text of the final and proposed amendments to Regulation CC, which have been reprinted from the *Federal Register* of November 2; copies will be furnished to others upon request directed to our Circularity Division (Tel. No. 212-720-5215 or 5216). Included in that excerpt is a proposed preemption determination with respect to New Jersey law, and a final determination regarding the laws of Connecticut and New York that have been preempted under Regulation CC.

Comments regarding the proposed amendments to Regulation CC should be submitted by December 30, 1988, and may be sent to the Board of Governors, as specified in the notice, or to John F. Sobala, Vice President, Check Processing Function of this Bank. (Comments regarding the New Jersey proposed preemption determination should be submitted to the Board by November 30.)

E. GERALD CORRIGAN,
President.

federal register

Wednesday
November 2, 1988

Part III

Federal Reserve System

12 CFR Part 229

Availability of Funds and Collection of Checks; Final and Proposed Rules and Interpretations

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FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Regulation CC; Docket No. R-0643]

Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting as a final rule, with minor technical changes, the interim amendment to Regulation CC it adopted in August. The Board adopted the interim rule to conform the definition of "paying bank" in Regulation CC to the Expedited Funds Availability Act as interpreted by a court decision. The court found that in defining a payable through bank as the paying bank where a check is written on one bank but payable through another, Regulation CC was inconsistent with the language of the Act.

EFFECTIVE DATE: October 25, 1988.

FOR FURTHER INFORMATION CONTACT: Joseph R. Alexander, Senior Attorney (202/452-2489), Stephanie Martin, Attorney (202/452-3198), Legal Division; Louise L. Roseman, Assistant Director, Division of Federal Reserve Bank Operations (202/452-3874); Kathleen Brueger, Staff Attorney, Division of Community and Consumer Affairs (202/452-2412). For the hearing impaired only: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

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 bank must make the funds available to the depositor, the regulations provided that where a check is payable by one bank but payable through another and sent to the payable through bank for payment or collection, the location of

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 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. The court granted the plaintiffs' motion for a 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 Act and Regulation CC took effect five weeks after the court rendered its decision. In order to clarify the duties of banks and others in light of the court's order, the Board issued temporary conforming amendments to Regulation CC. The Board also requested comment on the interim rules pending the Board's consideration of a final rule. 53 FR 31290 (August 18, 1988).

The interim rule primarily affected the definitions and the disclosure rules. Where a check is payable by one bank but payable through another bank, the interim rule provided that the check would be considered local or nonlocal by reference to the location of the payor bank, not by reference to the payable through bank. The interim rule did not affect payable through checks payable by nonbank payors. Further, as payable through checks bear the routing number of the payable through bank, not the payor, provisions in Regulation CC that allowed a depository bank to rely on the routing number to determine whether a check is local or nonlocal were amended. The interim rule also permitted banks whose initial disclosures were affected by the court's decision to comply with the Act by sending to their customers simple clarifying notices in regularly scheduled meetings.

Approximately 93 percent of the 155 comments the Board received on the

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).

interim rule objected to the treatment of bank payable through checks as local or nonlocal based on the location of the payor bank, because the rule creates operational difficulties and increases risks for depository banks. Many of the commenters suggested means of addressing these operational problems and risks. In a related action today, the Board has requested comment on several proposals to alleviate these operational problems and risks. (See Docket No. R-0648.)

After consideration of the comments, the Board has determined to adopt in final form the interim rule with two technical changes:

(1) To insert the word "or" after the fourth element in the definition of "paying bank," and

(2) Clarify in the disclosure rules and the Commentary that a bank that makes funds available within the time periods required for local checks is not required to make the special disclosure.

List of Subjects in 12 CFR Part 229

Banks, Banking, Federal Reserve System.

Accordingly, the interim rule amending Regulation CC, 12 CFR Part 229, which was published at 53 FR 31290-31296 on August 18, 1988, is adopted as a final rule with the following changes:

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. Section 229.2(z)(4) is revised to read as follows:

§ 229.2 Definitions.

* * * * *

(z) * * *

(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; or

* * * * *

§ 229.16 [Amended]

3. Section 229.16(b)(2) is amended by adding after the first sentence of the footnote the following new sentence to read as follows:

* * * * * A bank that makes funds from nonlocal checks available for withdrawal within the time periods required for local checks under §§ 229.11, 229.12, and 229.13 is not required to provide this disclosure on payable through checks to its customers. * * *

4. Appendix E—Commentary to Part 229, is amended by adding following the

fourth paragraph of the Commentary to § 229.16(b) a new paragraph to read as follows:

Appendix E—Commentary

* * * * *

Section 229.16 Specific Availability Policy Disclosures

(b) * * *

Generally, a bank that distinguishes in its disclosure between local and nonlocal checks based on the routing number on the check must disclose to its customers that certain checks, such as some credit union payable through drafts, will be treated as local or nonlocal based on the location of the bank by which they are payable (e.g., the credit union), and not on the basis of the location of the bank whose routing number appears on the check. A bank is not required to provide this disclosure, however, if it makes the proceeds of both local and nonlocal checks available for withdrawal within the time periods required for local checks in §§ 229.11, 229.12, and 229.13.

* * * * *

By order of the Board of Governors of the Federal Reserve System, October 25, 1988.

William S. Wiles,

Secretary of the Board.

[FR Doc. 88-25038 Filed 11-1-88; 8:45 am]

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FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Regulation CC; Docket Nos. R-0640 and R-0644]

Availability of Funds and Collection of Checks; Preemption Determinations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final interpretations.

SUMMARY: The Board is publishing final official Board interpretations concerning preemption determinations under its Regulation CC, Availability of Funds and Collection of Checks, for the laws of California, Connecticut, Maine, Massachusetts, New Mexico, New York, and Rhode Island. The Expedited Funds Availability Act provides standards for determining whether State law governing funds availability supersedes, or is preempted by Federal law. Under Regulation CC, the Board will issue preemption determinations with respect to State law upon request.

EFFECTIVE DATE: October 25, 1988.

FOR FURTHER INFORMATION CONTACT: Oliver Ireland, Associate General Counsel (202/452-3625), Joseph R. Alexander, Senior Attorney (202/452-2489), or Stephanie Martin, Attorney (202/452-3198), Legal Division; or Louise L. Roseman, Assistant Director (202/

452-3874), Division of Federal Reserve Bank Operations; for the hearing impaired only: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

On May 13, 1988, the Board adopted Regulation CC to carry out the provisions of the Expedited Funds Availability Act (the "Act") (12 U.S.C. 4001-4010). The regulation requires banks to make funds available to their customers within specified time frames and to disclose their funds availability policies to their customers. A number of states have also enacted rules governing funds availability. The Act (Section 608) and Regulation CC (§ 229.20) provide that any provision of state law in effect on or before September 1, 1989, that provides for a shorter hold for a category of checks than is provided under federal law will supersede the federal provision.

Provisions of state law governing funds availability that permit a bank to make funds available for withdrawal in a longer period than permitted under Regulation CC are considered inconsistent and are preempted by Regulation CC. In addition, state disclosure and notice requirements concerning funds availability related to accounts covered by Regulation CC are preempted by the federal disclosure scheme.

Regulation CC provides for Board determinations of whether state law related to the availability of funds is preempted by federal law upon the request of a state, bank, or other interested party.

Discussion

The Board issued for public comment proposed preemption determinations with respect to the laws of Illinois, Maine, and New York on June 22, 1988, 53 FR 24315 (June 28, 1988). At that time, the Board also requested comment on the preemption of proposed amendments to the New York law. The Board issued a final determination with respect to Illinois and New York law on August 18, 1988, 53 FR 32354 (August 24, 1988). The Board deferred final action with respect to Maine law, at the request of the Maine Attorney General's Office, pending the adoption of a revised state regulation. Maine and New York subsequently adopted amendments to their funds availability regulations to conform the state laws more closely to the federal Regulation CC requirements. The revised regulations of both states became effective on September 1, 1988. The Board is now publishing final preemption determinations with respect to the recently adopted laws of Maine

and recently amended New York rules.

On August 18, 1988, the Board issued for public comment proposed preemption determinations with respect to the laws of California, Connecticut, Massachusetts, New Mexico, and Rhode Island, 53 FR 32359 (August 24, 1988). The Board received 14 comments on the proposals, which are summarized below. The Board is now publishing final preemption determinations with respect to the laws of these states.

The Board set out principles, at the time it adopted several final state preemption determinations in August, as guides for future preemption determinations. 53 FR 32354 (August 24, 1988). Those principles have been followed in these determinations as well.

Notice of exception hold. The Board adopted in August a preemption principle stating that the state exceptions continue to apply only in those cases where the state schedule is shorter than or equal to the federal schedule, and then only up to the limit permitted by the Regulation CC schedule. The hold can then be further extended by the federal exception in accordance with Regulation CC. Only one exception notice is required where a bank applies a state exception to extend a shorter state schedule to the federal limit, and also a federal exception to further extend the hold. This notice, which must be provided in accordance with § 229.13(g), need only include as the reason the exception was invoked the applicable federal exception.

Disclosures. Section 229.20(c) of Regulation CC provides that state law may be inconsistent with Regulation CC, and therefore may be preempted, where it provides for disclosures or notices concerning funds availability relating to accounts. This rule avoids redundant disclosures and variations in disclosures between states that may confuse bank customers. Some states, however, such as Maine and Massachusetts, require by state law that depository institutions in those states disclose their funds availability policies in accordance with the federal law. Such laws permit the state to enforce disclosure requirements, but do not result in redundancy or variations in disclosure requirements. Because such disclosures are not inconsistent with the disclosure requirements of Regulation CC, they are not preempted by the federal law.

* * *

Connecticut. Connecticut law provides availability schedules for deposits of on us checks, in-state checks, and out-of-state checks. The state law also provides certain exceptions to those schedules. Generally, the state schedules and

exceptions allow longer hold periods than the federal schedules and Regulation CC will preempt; however, out-of-state nonlocal checks will continue to be governed by the shorter state schedule. The state schedules will also continue to apply to items such as nonnegotiable instruments that are not covered by Regulation CC. In addition, the Connecticut law, including disclosure requirements, will continue to apply to accounts, such as savings and time accounts, not subject to Regulation CC. The Board has adopted the proposed Connecticut determination, with revisions addressing a commenter's question relating to the treatment of certain payable through drafts.

New York. The Board published for public comment a proposed preemption determination with respect to the New York funds availability law on June 22, 1988. At that time, the Board also requested comment on the preemption of proposed amendments to the New York law. Because the Board was not requested to defer its final preemption determination pending the adoption of the proposed revision to New York law, it issued a final determination with respect to New York law on August 18, 1988.

New York recently adopted, in final form, amendments to its funds availability regulation. The amendments generally exclude accounts covered by Regulation CC from the scope of the state funds availability requirements. The revised New York law, however, continues to apply the state schedule for in-state nonlocal checks to deposits of these checks to accounts subject to Regulation CC. The amendment also provides that, with respect to time and savings accounts, New York institutions could continue to follow the New York availability and disclosure requirements, or could comply with those contained in Regulation CC. The Board has determined that New York law supersedes federal law to the extent that it requires shorter availability for deposits of in-state nonlocal checks to accounts subject to Regulation CC.

Summary of Comments

The Board received 14 comments on the proposed preemption determinations issued in August 1988. Twelve of the comments addressed the proposed preemption determination for California. One comment addressed the proposal for Connecticut, and one addressed the proposal for Massachusetts. The Board received no comments concerning the proposals for New Mexico and Rhode Island.

Connecticut. One Connecticut law firm commented on the proposed

preemption determination for Connecticut. The commenter pointed out that Connecticut law defines "item" as "any instrument for the payment of money even though it is not negotiable." The commenter asked for clarification as to whether the Board considers the state's definition to exclude payable through drafts payable by a nondepository institution.

The commenter requested that when a state exception hold is placed on deposited funds and consequently a federal exception is also invoked, a single notice to the customer should be sufficient. The commenter noted that because Connecticut's reasonable cause exception could conceivably encompass all of the exceptions listed in § 229.13 of Regulation CC, the reason for hold contained in the notice could be any of the federal exceptions that applied to the deposit.

Finally, the commenter asked that, in cases where the Connecticut new account exception is invoked, Regulation CC's definition of "new account" should apply, i.e., the state new account exception should apply during the first 30 days the account is open rather than only to those items which are received for deposit at the moment the account is opened. The commenter argues that, under the temporary schedule, banks should be able to use the federal new account exception for both local checks (which are subject to the federal availability schedule) and nonlocal out-of-state checks (which are subject to the state availability schedule).

List of Subjects in 12 CFR Part 229

Banks, Banking, Federal Reserve System.

For the reasons set out in the preamble, 12 CFR Part 229 is amended as follows:

PART 229—[AMENDED]

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. Appendix F is amended by removing the New York preemption determination, and adding preemption determinations for the states of California, Connecticut, Maine, Massachusetts, New Mexico, New York, and Rhode Island alphabetically to read as follows:

Appendix F—Official Board Interpretations; Preemption Determinations

Connecticut
Background

The Board has been requested, in

accordance with § 229.20(d) of Regulation CC (12 CFR Part 229), to determine whether the Expedited Funds Availability Act (the "Act") and Subpart B (and in connection therewith, Subpart A) of Regulation CC, preempt provisions of Connecticut law relating to the availability of funds. This preemption determination specifies those provisions of the Connecticut funds availability law that supersede the Act and Regulation CC. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4-213(5), pertaining to availability of cash deposits.)

In 1987, Connecticut amended its statute governing funds availability (Conn. Gen. Stat. section 36-9v), which requires Connecticut depository institutions to make funds deposited in a checking, time, interest, or savings account available for withdrawal with specified periods.

Generally, the Connecticut statute, as amended, provides that items deposited in a checking, time, interest, or savings account at a depository institution must be available for withdrawal in accordance with the following table:

	<i>Availability</i>
On us checks.....	2nd day
In-state checks.....	4th day
Out-of-state checks.....	6th day

Exceptions to the schedules are provided for items received for deposit for the purpose of opening an account and for items that the depository bank has reason to believe will not clear. The Connecticut statute also requires availability policy disclosures to depositors in the form of written notices and notices posted conspicuously at each branch.

Coverage

The Connecticut statute governs the availability of funds deposited in savings and time accounts, as well as "accounts" as defined in § 229.2(a) of Regulation CC. The federal preemption of state funds availability requirements only applies to "accounts" subject to Regulation CC, which generally consist of transaction accounts. Regulation CC does not affect the Connecticut statute to the extent that the state law applies to deposits in savings and other accounts (including transaction accounts where the account holder is a bank, foreign bank or the U.S. Treasury) that are not "accounts" under Regulation CC. (Note, however, that under § 229.19(e) of Regulation CC, *Holds on other funds*, the federal availability schedules may apply to savings, time, and other accounts not defined as "accounts" under Regulation CC, in certain circumstances.)

The Connecticut statute applies to "items" deposited in accounts. This term encompasses instruments that are not defined as "checks" in Regulation CC (§ 229.2(k)), such as nonnegotiable instruments, and are therefore not subject to Regulation CC's provisions governing funds availability. Those items that are subject to Connecticut law but are not subject to Regulation CC will continue to be covered by the state availability schedules and exceptions.

Availability Schedules

Temporary schedule. Connecticut law provides that certain checks that are nonlocal

under Regulation CC must be available in a shorter time (sixth business day after deposit for checks payable by depository institutions not located in Connecticut) than under the federal regulation (seventh business day after deposit under the temporary schedule for nonlocal checks). Accordingly, the Connecticut law supersedes Regulation CC with respect to nonlocal checks (other than checks covered by Appendix B-1) deposited in "accounts" until the federal permanent availability schedules take effect on September 1, 1990.

The Connecticut statute does not specify whether it applies to deposits of checks at nonproprietary ATMs. Under the temporary schedule in Regulation CC, deposits at nonproprietary ATMs must be made available for withdrawal at the start of the seventh business day after deposit. To the extent that the Connecticut schedules provide for shorter availability for deposits at nonproprietary ATMs, they would supersede the temporary schedule in Regulation CC for deposits at nonproprietary ATMs specified in § 229.11(d).

Exceptions to the availability schedule. The Connecticut law provides exceptions for items received for deposit for the purpose of opening new accounts and for items that the depository bank has reason to believe will not clear. In all cases where the federal availability schedule preempts the state schedule, only the federal exceptions will apply. For deposits that are covered by the state availability schedule (e.g., nonlocal out-of-state checks under the temporary schedule), the state exceptions may be used to extend the state availability schedule (of six business days) to meet the federal availability schedule (of seven business days). Once the deposit is held up to the federal availability schedule limit under a state exception, the depository bank may further extend the hold under any federal exception that can be applied to the deposit. Any time a depository bank invokes an exception to extend a hold beyond the time periods otherwise permitted by law, it must give notice of the extended hold to its customer, in accordance with § 229.13(g) of Regulation CC.

Disclosures

The Connecticut statute (Conn. Gen. Stat. Section 36-9v(b)) requires written notice to depositors of an institution's check hold policy and requires a notice of the policy to be posted in each branch.

Regulation CC preempts state disclosure requirements concerning funds availability that relate to "accounts" that are inconsistent with the federal requirements. The state requirements are different from, and therefore inconsistent with, the federal disclosure rules. (§ 229.20(c)(2)). Thus, the Connecticut statute is preempted by Regulation CC to the extent that these disclosure provisions apply to "accounts" as defined by Regulation CC. The Connecticut disclosure rules would continue to apply to accounts, such as savings and time accounts, not governed by the Regulation CC disclosure requirements.

New York Background

The Board has been requested, in accordance with § 229.20(d) of Regulation CC

(12 CFR Part 229), to determine whether the Expedited Funds Availability Act (the "Act") and Subpart B (and in connection therewith, Subpart A) of Regulation CC, preempt the provisions of New York law concerning the availability of funds. This preemption determination addresses the relation of the Act and Regulation CC to the New York funds availability law. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4-213(5), pertaining to availability of cash deposits.)

In 1983, the New York State Banking Department, pursuant to section 14-d of the New York Banking law, issued regulations requiring that funds deposited in an account be made available for withdrawal within specified time periods, and provided certain exceptions to those availability schedules. Part 34 of the New York State Banking Department's General Regulations established time frames within which commercial banks, trust companies, and branches of foreign banks ("banks"); and savings banks, savings and loan associations, and credit unions ("savings institutions") must make funds deposited in customer accounts available for withdrawal.

The Banking Department amended Part 34, effective September 1, 1988, generally to exclude accounts covered by Regulation CC from the scope of the state regulation. Part 34.4 (a)(2) and (b)(2) of the revised New York rules, however, continue to apply to checks deposited to accounts, as defined in Regulation CC. These provisions require that the proceeds of nonlocal checks payable by a New York institution be made available for withdrawal not later than the start of the fourth business day following deposit, if deposited in a bank, or the fifth business day following deposit, if deposited in a savings institution. The revised regulation also provides that, with respect to savings accounts and time deposits, New York institutions could elect to comply with either the state or federal availability and disclosure requirements.

This preemption determination supersedes the determination issued by the Board on August 18, 1988 (53 FR 32357 (August 24, 1988)).

Coverage

The New York law and regulation govern the availability of funds in savings accounts and time deposits, as well as "accounts" as defined in § 229.2(a) of Regulation CC. The New York law continues to apply to deposits to savings accounts and time deposits that are not accounts under Regulation CC. (Note, however, that under § 229.19(e) of Regulation CC, *Hold on other funds*, the federal availability schedules may apply to savings, time, and other accounts not defined as "accounts" under Regulation CC, in certain circumstances.)

The New York law and regulation apply to "items" deposited to accounts. Part 34.3(e) defines "item" as "a check, negotiable order of withdrawal or money order deposited into an account." The Board interprets the definition of "item" in New York law to be consistent with the definition of "check" in Regulation CC (§ 229.2(k)).

Availability Schedules

The provisions of New York law governing the availability of in-state nonlocal items

provide for shorter hold than is provided under Regulation CC, and supersede that federal availability requirements. With the exception of these provisions, the New York regulation does not apply to deposits to accounts covered by Regulation CC.

Temporary schedule. The time periods for the availability of in-state nonlocal checks, contained in Part 34.4 (a)(2) and (b)(2), are shorter than the seventh business day availability required for nonlocal checks under § 229.11(c) of Regulation CC, although they are not necessarily shorter than the schedules for nonlocal checks set forth in § 229.11(c)(2) and Appendix B-1 of Regulation CC. Thus, these state schedules supersede the federal schedule to the extent that they apply to an item payable by a New York bank or savings institution that is defined as a nonlocal check under Regulation CC and the applicable state schedule is less than the applicable schedule specified in § 229.11(c) and Appendix B-1.

Permanent schedule. The New York schedule for banks supersedes the Regulation CC requirement in the permanent schedule, effective September 1, 1990, that nonlocal checks be made available for withdrawal by the start of the fifth business day following deposit, to the extent that the in-state checks are defined as nonlocal under Regulation CC, and the Regulation CC schedule for nonlocal checks is not shortened under § 229.12(c)(2) and Appendix B-2 of Regulation CC. In addition, the New York schedule for savings institutions supersedes the Regulation CC time period adjustment for withdrawal by cash or similar means in the permanent schedule, to the extent that the in-state checks are defined as nonlocal under Regulation CC, and the Regulation CC schedule for nonlocal checks is not shortened under § 229.12(c)(2) and Appendix B-2.

Exceptions to the availability schedules. New York law provides exceptions to the state availability schedules for large deposits, new accounts, repeated overdrafts, doubtful collectibility, foreign items, and emergency conditions (Part 34.4). The state exceptions apply only with respect to deposits of in-state nonlocal checks that are subject to the state availability schedule. For these deposits, the depository bank may invoke a state exception and place a hold on the deposit up to the federal availability schedule limit for that type of deposit. Once the federal availability schedule limit is reached, the depository bank may further extend the hold under any of the federal exceptions that apply to that deposit. Any time a depository bank invokes an exception to extend a hold beyond the time periods otherwise permitted by law, it must give notice of the extended hold to its customer in accordance with § 229.12(g) of Regulation CC.

Disclosures

The revised New York regulation does not contain funds availability disclosure requirements applicable to accounts subject to Regulation CC.

* * *

By order of the Board of Governors of the Federal Reserve System, October 25, 1988.

William W. Wiles,
Secretary of the Board.

[FR Doc. 88-25034 Filed 11-1-88; 8:45 am]

BILLING CODE 6210-01-05

FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Regulation CC; Docket No. R-0648]

Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is publishing for comment proposed amendments to its Regulation CC, Availability of Funds and Collections of Checks (12 CFR Part 229). The proposed rule changes would alleviate the operational difficulties and additional risks associated with the acceptance for deposit of payable through checks.

DATES: Comments must be submitted on or before December 30, 1988.

ADDRESSES: Comments, which should refer to Docket No. R-0648, 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 at the above address will be included in the public file and may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202/452-3874), Gayle Thompson, Program Leader (202/452-2934), Division of Federal Reserve Bank Operations; Oliver Ireland, Associate General Counsel (202/452-3625), Stephanie Martin, Attorney (202/452-3198), Legal Division; for the hearing impaired *only*: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: The Board has adopted, with minor technical changes, the interim rule issued on August 18, 1988, to amend Regulation CC to treat "bank payable through checks" as local or nonlocal based on the location of the bank¹ on which they are written rather than the location of the bank through which they are payable, as a final rule. (See Docket R-0643, published elsewhere in today's Federal Register.) The Board is issuing, for a 60-day public comment period, proposed amendments to Regulation CC designed to alleviate the operational

¹ Regulation CC defines bank to include all depository institutions, including commercial banks, savings and loan associations, and credit unions. A depository bank is defined as the first bank to which a check is transferred.

difficulties and additional risks resulting from this final rule.

Background

As adopted in May 1988, Regulation CC provided that checks written on an account at one bank but payable through another bank were to be considered local or nonlocal under Regulation CC and the Expedited Funds Availability Act ("Act") based on the location of the bank designated as the payable through bank. This treatment of "bank payable through checks" was consistent with the scheme set forth in the Act to permit banks to place longer holds on checks that must be sent to nonlocal banks for collection because such checks generally take longer to collect and return than checks sent to local banks for collection and, therefore, could pose greater risks for depository banks.² In addition, treating the payable through bank as the paying bank would facilitate the handling of these checks by depository banks because it would permit them to use automated equipment to read the routing number of the payable through bank encoded on a check, which indicates the check processing region where the payable through bank is located, and to assign availability for the check on the basis of that number.

Shortly after the Board adopted Regulation CC defining the payable through bank as the paying bank and thus allowing bank payable through checks to be treated as local or nonlocal according to the location of the payable through bank, the Credit Union National Association ("CUNA") and one of its member credit unions brought suit asserting that this rule was contrary to the provisions of the Act, and that such checks, in particular credit union share drafts, should be treated as local or nonlocal on the basis of the location of the bank on which they are written, rather than the location of the payable through bank. CUNA believed that the treatment of bank payable through checks adopted by the Board would have an adverse effect on the acceptability of these checks as a form of payment because most credit union

² Under the regulation, depository banks may differentiate funds availability based on whether the check is written on a local or nonlocal paying bank. A local paying bank is one located in the same check processing region as the depository bank. As of September 1, 1988, depository banks must make the proceeds of local checks available for withdrawal not later than three business days following deposit; nonlocal checks must be made available for withdrawal not later than seven business days following deposit. On September 1, 1990, these schedules are reduced to two and five business days for local and nonlocal checks, respectively.

payable through checks would be treated as nonlocal, even though they would generally be deposited in a bank local to the credit union. CUNA argued that if these checks were generally treated as nonlocal, a large number of credit unions that offer payable through share draft accounts would be disadvantaged.

On July 28, 1988, the U.S. District Court for the District of Columbia ruled that under the language of the Act, bank payable through checks should be treated as local or nonlocal on the basis of the location of the credit union rather than the location of the payable through bank. On August 18, 1988, the Board adopted interim amendments to Regulation CC to implement the court's decision and requested comment on the interim rule pending consideration of a longer term response to the court's interpretation of the Act. 53 FR 31290 (August 18, 1988). The interim rule applied the court's decision to all bank payable through checks rather than only those written on credit unions.

The Board received 155 comments on the interim rule. (A summary of the comments appears below.) The overwhelming majority of the commenters (144) objected to the treatment of bank payable through checks as local or nonlocal on the basis of the location of the bank on which they are written, because this rule creates operational difficulties and increased risks for depository banks. Many of the commenters suggested various means of addressing these operational problems and risks.

The Board has adopted the interim rule, with minor technical changes, and is also proposing for comment amendments to Regulation CC designed to alleviate the operational difficulties and increased risks resulting from the interim rule. These proposed amendments are based on specific suggestions of the commenters and on subsequent discussions with industry representatives and the Industry Return Item Advisory Group, which includes representatives of commercial banks, savings and loan associations, and credit unions. The Board is issuing these proposals for comment to gain further information concerning whether the proposals are necessary to facilitate compliance with the revised regulation and to improve the check system by speeding the collection and return of payable through checks, and whether they impose undue burdens on the banks on which bank payable through checks are written.

Discussion

Although bank payable through checks represent only two to three percent of the approximately 47 billion checks written each year, they are sufficiently prevalent to create substantial operational problems for banks in complying with the Act, as interpreted by the court, and Regulation CC, as amended by the interim rule, and to increase the risk of check fraud for depository banks. Available data indicate that the two largest payable through processors handle approximately 700 million bank payable through checks each year. Although the majority of bank payable through checks are written on the more than 4,000 credit unions that use such checks, they are also used by some savings and loan associations and commercial banks. The Board has identified at least 65 banks across the country that serve as payable through banks and believes that others exist that have not yet been identified.

Ordinarily, many banks that provide different availability for local and nonlocal checks identify the checks as local or nonlocal based on the routing number in the Magnetic Ink Character Recognition ("MICR") line on the bottom of the checks. This routing number is either entered into the bank's computer system by the teller at the time the transaction is made (on-line processing) or read from the check using automated equipment during subsequent processing (batch processing). The first four digits of the nine-digit routing number are used to identify the Federal Reserve check processing region to which the check is sent for payment and thus permit the bank to readily identify whether a check is local or nonlocal. In the case of a bank payable through check, however, the routing number cannot be used to determine whether the check is local or nonlocal because it identifies the payable through bank rather than the bank on which the check is written.

Accordingly, in order to determine whether a check is local or nonlocal, depository banks must first determine whether it is a payable through check. Generally, there are two ways to identify these checks. First, they can be identified by visual inspection by the teller at the time that the checks are received for deposit. This procedure is labor intensive, and therefore costly, and prone to the high level of errors associated with manual processing. Once a check is identified as a payable through check, it may still be difficult to determine whether the check is local or nonlocal because some bank payable through checks do not contain on the

face of the check the location of the bank on which they are written. Even if this information is included on the face of the check, the local/nonlocal determination may be difficult to make due to the information's placement on the check or its type size. In addition, in cases where the location is clearly identifiable, it may be a difficult task to determine whether the bank on which the check is written is in the same check processing region as the depository bank, because most check processing regions contain only portions of states. The depository bank may need to refer to a list of cities and towns in its check processing region to determine if the bank payable through check is local for purposes of Regulation CC.³

The second way to identify bank payable through checks is to program a check reader-sorter to outsort all checks bearing the routing number of the payable through banks and either to assign those checks local availability, even when they are not payable by a local bank, or to inspect them visually to determine whether they should be assigned local or nonlocal availability. Although many bank payable through checks bear routing numbers that are used almost exclusively for such checks, others bear routing numbers that are also used for significant numbers of non-payable through checks. In addition, some payable through banks serve banks in a number of Federal Reserve check processing regions. Treating all checks bearing the routing number of a payable through bank as local also results in giving local availability to an unknown number of checks that may be treated as nonlocal. In addition, it creates an incentive for banks to act as payable through banks so that their checks may be considered local by banks that use this approach to comply. Further, as noted above, it is difficult to identify all banks that serve as payable through banks. A bank may begin or cease acting as a payable through bank at any time. Any listing of payable through bank routing numbers is likely to omit certain payable through banks, thus causing banks relying on that list to violate the Act by giving nonlocal availability to checks that should receive local availability under the Act. Finally, commenters indicated that if a bank wishes to inspect bank payable through checks visually once they have been identified in order to determine whether they are local or nonlocal, that process will be costly and error-prone

³ Listings of cities and states in individual Federal Reserve check processing regions are available upon request from local Federal Reserve Bank offices.

and may delay the collection of those checks.

In addition to the operating problems caused by bank payable through checks, these checks are attractive vehicles for check fraud. The time that it takes bank payable through checks to travel to and from the depository banks is a function of its location in relation to the payable through bank, not the bank on which the check is written.⁴ Consequently, it generally takes longer for checks that are sent to a nonlocal payable through bank to be collected and returned than it does for checks that are sent to a local bank. In the case of many depository banks, these collection and return times will regularly exceed the availability schedules in the Act for local checks. Persons wishing to commit check fraud on those depository banks would be able to rely on the fact that the bank must make the proceeds of the checks available for withdrawal before it had an opportunity to learn that the checks had been dishonored.

Under the Expedited Funds Availability Act, the Board has the authority to adopt regulations to address these problems. Although the language of the Act governing the availability of checks is sufficiently specific for the court to conclude that the Act requires local availability for bank payable through checks written on local banks but payable through nonlocal banks, the Act gives the Board general authority to regulate the check collection system. Section 809(c)(1) of the Act provides:

RESPONSIBILITY FOR PAYMENT SYSTEM—In order to carry out the provisions of this title, the Board of Governors of the Federal Reserve System shall have the responsibility to regulate—

(A) Any aspect of the payment system, including the receipt, payment, collection, or clearing of checks; and

(B) Any related function of the payment system with respect to checks.

This authority is extremely broad and, together with section 809(a) of the Act, which authorizes the Board to prescribe rules to facilitate compliance with the Act, gives the Board the authority to adopt reasonable changes to the way that checks are handled, provided that those changes further the purposes of

⁴ Chase Manhattan, one of the two major national payable through processors, stated in its comments: " * * * if the payor bank decides not to pay a draft, the time that it takes the draft to travel to the depository bank is a function of its location in relation to the payable through bank, not the payor bank. Therefore, when a payable through bank returns a draft received from a nonlocal depository bank, it must be afforded the benefit of the longer return time for nonlocal items notwithstanding that the payor bank may be in the same check processing region as the depository bank."

the Act, such as by expediting the collection and return of checks or facilitating compliance with the availability schedules.

The Board believes that there are a number of approaches to dealing with the operational and risk problems associated with bank payable through checks, including: (1) Requiring such checks to be presentable locally and to bear a local routing number in the MICR line; (2) requiring such checks to be conspicuously labeled as payable through checks, specifying the name and location of the payable through bank and the name, location, and nine-digit routing number of the bank on which the check is written; (3) authorizing collecting banks to present such checks directly to the bank on which they are written; and (4) shifting to the bank on which the check is written the risks of loss due to the time required for the return of such checks from nonlocal payable through banks.

1. *Require bank payable through checks to be presentable locally and bear a local routing number in the MICR line.* Eighty-nine commenters expressed concern about the operational problems posed by the court ruling and interim amendments. A number of these commenters suggested that the Board require credit unions to encode their own routing numbers on their checks, or that of a local payable through bank. This would permit depository banks to determine whether any check is local or nonlocal through the use of automated equipment, because the routing number encoded on the check would indicate the check processing region of the bank on which the check is written. Therefore, this approach would effectively remove the operational difficulties in assigning appropriate availability to these checks.

In addition, this proposal would address the concerns expressed by 111 commenters the potential risk of additional losses and increased exposure to fraud for depository banks as a result of the revised rule defining the bank on which the payable through check is written as the paying bank for determining funds availability. The proposal would eliminate the likelihood that these checks would become attractive vehicles for check fraud because a bank payable through check with a local routing number could be presented to the local address associated with the routing number, maintaining a clear link between the time it takes to collect and return the check and the time within which the depository bank must make the funds available to the depositor.

This proposal would require the reissuance of payable through checks encoded with routing numbers not associated with the same check processing region as the bank on which the checks are written and may also require a bank to change its payable through check processor. The cost of reissuing checks and converting to a different processor depends, in part, on the lead time between the adoption of the proposal in final form and the effective date of this requirement. These costs would have to be weighed against the costs to the banking industry in general of identifying bank payable through checks by other means and the risks arising from the use of nonlocal payable through banks for these checks.⁵

When some credit unions began offering share draft accounts to their members in the mid-1970s, they used payable through banks exclusively to process checks written on those accounts (predominantly two national payable through processors), in part due to competitive concerns with having local banks processing their checks. With the enactment of the Monetary Control Act of 1980, credit unions were able to obtain their own routing numbers, and thus had greater processing options. In addition, other service providers began offering share draft processing services to credit unions, including correspondent banks, corporate credit unions, state credit union leagues, credit union service organizations, regional data processors, and service bureaus.

According to CUNA, the current trend is for credit unions to shift to local processors or in-house processing. CUNA reports that six percent of credit unions now process in-house, while 25 percent use local processors in an intercept arrangement, rather than a payable through arrangement. (In an intercept arrangement, the credit union uses its own routing number on its checks, rather than the routing number of the processor.) The remaining 69 percent of credit unions use a payable through bank for processing, a small

⁵ One industry consultant indicated that "on average, 80 to 85% of [credit union] members will reorder [share drafts] in a nine to twelve month period." (July 18, 1988, affidavit of David McCurrech, President of McCurrech & Company.) Dearborn Federal Credit Union, in a June 18, 1988 affidavit, noted that, if it were to convert to local processing, it must either incur the costs of reprinting share drafts for all of the credit union's members (estimated at \$7 per member), or incur the cost of operating a full-scale dual processing system for one year while some members are converting to new share drafts and others are using up their old payable through share drafts.

portion of which use a local payable through bank.

The proposed requirement would not necessarily preclude nonlocal processing of payable through checks. Currently, arrangements exist whereby payable through checks are delivered to a local presentment point and subsequently transported to the nonlocal processing site. For example, some corporate credit unions serve market areas that encompass multiple check processing regions, and thereby provide services to members located in one or more nonlocal check processing regions. Such arrangements tend to be regional rather than national in scope due to transportation times necessary to move the payable through checks from the presentment point to the processing site. Thus, this proposal might cause a shift from national payable through processing to regional or in-house processing. On the other hand, national payable through processors could develop regional operations in order to continue to provide services to banks that issue payable through checks.⁶

The Board considered, as an alternative to this proposal, a proposal to require payable through checks to be identified as such in the MICR line of the check. There is only one field in the MICR line (position 44) that such information can be contained. Because this field is also used to identify checks, including payable through checks, for other purposes (e.g., to identify the check as eligible for truncation), and because the industry is interested in reserving the use of this field for a number of other purposes, this alternative is not attractive. Moreover, this approach would only indicate to the depository bank whether the check is a payable through check; it would not provide sufficient information to determine, in an automated environment, whether a payable through check is local or nonlocal.

The Board is publishing for comment a proposed amendment to Regulation CC to require bank payable through checks to bear a routing number in the MICR line that is associated with the same check processing region as the location of the bank on which the check is written, and to require a presentment point for such checks in that check processing region. This requirement would be effective one year following

⁶ Traveler's Express, one of the two major national payable through processors, has established three regional processing centers in the past four years, and has stated that it plans to establish additional regional processing sites in the future, in order to retain credit union customers that are seeking local processing.

banks is not clear. The banks generally already receive direct presentment of some checks over the counter for their customers. Further, the extent to which the volume of checks presented directly would increase is unknown. The presentment of a significant number of such checks may cause operational burdens for these banks because they are generally not equipped to process large volumes of checks. The need for this rule would be diminished if bank payable through checks were required to have a local routing number in the MICR line, and a corresponding local presentment point.

The Board is publishing for comment an amendment to Regulation CC that would authorize direct presentment of bank payable through checks. The Board specifically requests comment on the cost and operational burden of this proposal on banks that use payable through checks, the potential cost savings to depository banks, and the appropriate lead time for implementation of the proposal, if it is adopted.

4. *Shift risk of loss to bank on which check is written.* One hundred eleven commenters expressed concern regarding the potential risks of losses and increased exposure to fraud for depository banks as a result of the revised rule defining the bank on which the payable through check is written as the paying bank for determining funds availability.

Commenters argued that checks considered local for determining availability should also be considered local for determining whether the checks are returned expeditiously so that the risks to depository banks would not be increased by the revised rule. These commenters suggested that the revised definition of paying bank also be applied to the expeditious return rules in Subpart C of the regulation.

The effect of the revision suggested by the commenters can also be achieved by requiring that the bank on which a payable through check is written bear any losses incurred by the depository bank due to return of a check from a nonlocal payable through bank in a time longer than would have been required for return of the check if it had been presented directly to the bank on which it was written. This rule would not address the operational difficulties in identifying these checks and would not protect the depository bank from risks due to any longer time required to present such checks to a nonlocal payable through bank. On the other hand, the burden that this rule would place on banks on which such checks are written would be minimal and

would be limited to losses for which they were responsible because of the location and return procedures of the payable through bank that they selected. The need for such a rule would be eliminated if bank payable through checks were required to have a local routing number in the MICR line and would be diminished if direct presentment of payable through checks were authorized.

The Board is publishing for comment an amendment to Regulation CC that would place the risk of loss for return of bank payable through checks from nonlocal payable through banks on the banks on which such checks are written, to the extent that the return from the nonlocal payable through bank took longer than would have been required if the check had been returned expeditiously by the bank on which it is written. The Board requests comment as to whether this allocated liability should be computed solely under the two-day/four-day test in § 229.30(a)(1) of Regulation CC or whether it is possible to also compute such liability under the forward collection test in § 229.30(a)(2). The Board also requests comment on the appropriate lead time for implementation of this proposal if it is adopted.

Summary of Proposals

These proposed amendments address many of the operational and risk concerns raised by the commenters in response to the revised rule adopted by the Board to treat bank payable through checks as local or nonlocal based on the location of the bank on which they are written rather than the location of the bank through which they are payable. The Board is publishing for public comment, the following proposed amendments to Regulation CC, to determine whether they would facilitate compliance with Regulation CC and improve the check system by speeding the collection and return of payable through checks, and whether they would impose undue burdens on the banks on which payable through checks are written.

1. Require bank payable through checks to be presentable locally and to bear a local routing number in the MICR line (See proposed regulatory language—amendments to § 229.36(b), (f) (Alternative 1), and (g) (Alternative 1);

2. Require bank payable through checks to be conspicuously labeled with the name, location, and nine-digit routing number of the bank on which the check is written and the legend "payable through" followed by the name and location of the payable through

bank (See proposed regulatory language—amendment to § 229.36(g) (Alternative 2). Alternative 3 combines Alternatives 1 and 2);

3. Authorize direct presentment to the bank on which bank payable through checks are written (See proposed regulatory language—amendments to § 229.36 (b) and (f) (Alternative 2); and

4. Allocate losses for return of bank payable through checks from a nonlocal payable through bank to the bank on which such checks are written, to the extent the process of return took longer than would have been required if the check had been returned by the bank on which they are written (See proposed regulatory language—amendment to § 229.38(d)(2)).

In addition, elsewhere in today's Federal Register, the Board is proposing for comment several other technical amendments to Regulation CC relating to payable through checks (see Docket R-0649).

Summary of Comments

The Board received a total of 155 comments on the interim rule. The following table reflects these comments by category of respondent:

Commercial Banks and Bank Holding Companies ¹	129
Credit Unions.....	3
Savings and Loan Associations.....	12
Trade Associations.....	6
Individuals.....	3

¹ Identical comments submitted by three employees of the same bank are counted as one comment.

A total of 144 commenters opposed the definition of paying bank as interpreted by the court decision. Fifty-three percent of the commenters urged the Board to appeal the court ruling. Ten commenters suggested that the Board should request that Congress amend the law. Five commenters concurred with the revisions made in the interim rule. The majority of the commenters discussed the operational concerns and the increased risk of fraud loss caused by the court ruling. They indicated the need for longer term initiatives aimed at easing the operational burden of identifying payable through drafts and minimizing the risk of fraud losses for depository banks.

Operational concerns. A total of 80 commenters expressed concern about the operational problems caused by the ruling. Banks will no longer be able to rely on the routing number to determine whether a bank payable through check is local or nonlocal. Commenters stated that they will have operational difficulties in assigning availability to

payable through checks. They expressed concern that depository banks will have to revert to a complex manual process in order to distinguish share drafts payable by local credit unions from other checks for the purpose of determining availability. Personnel will have to be trained to inspect each check visually to determine whether the check is local or nonlocal. Individual handling and visual inspection will create a larger probability of error and possibly cause delays in collection and return. Commenters were also concerned that tellers would have difficulty determining the availability of payable through checks based on the geographic location of the credit union, because most check processing regions contain only portions of certain states. Reference to a detailed listing of cities and towns in the depository bank's check processing region would often be required to determine accurately whether a credit union is local or nonlocal to the depository bank.

Commenters stated that determination of holds on a manual, rather than automated, basis would increase the expense of processing deposits and would decrease the efficiency of the processing, contrary to Congress' expressed intent in the Act that the Board takes steps to improve the check system. Camden National Bank, Camden, Maine, commented, "we are no longer in the Stone Age of check processing where an individual examines each item and sorts it. We are a small bank; however we do our own check processing and handle an average of 25,000 checks for deposit nightly." The Huntington National Bank, Huntington, Ohio, stated, "we process 20 million items per month on the basis of the routing transit number; the time and expense of sorting through these items by hand would be prohibitive." The commenters stated that the burden of identifying a local or nonlocal check has been placed on the depository bank without a standard industry identification procedure. The majority of the commenters believe that the routing number should continue to be the controlling determination for availability. They referred to the routing number method as efficient and proven.

Some commenters proposed initiatives to ease the operational burdens created by the interim rule. A few commenters requested that the Board develop an alternative method of identifying checks as local or nonlocal in an automated check processing environment. One commenter suggested that the credit union should be required to encode a character in the MICR line

to identify the check as a payable through check.

Ten commenters suggested that the credit union should have its own routing number printed on the face of the check. Commenters also recommended that, at a minimum, the credit unions should identify their checks as payable through and include their own name and address and the name of the payable through bank on the face of the check.

A number of commenters suggested that a list should be developed of the credit unions that use nonlocal payable through banks. Another alternative suggested was a list of routing numbers for all payable through banks in each Federal Reserve district.

Fifteen commenters recommended that the Board should allow depository banks to require the use of a special deposit slip for payable through checks that are to be treated as local items. They noted that Regulation CC currently requires special deposit slips for certain next-day items and suggested that the same rules apply to payable through checks. The special deposit slips would make these items more easily identifiable for tellers.

Risk of fraud loss. One hundred eleven commenters expressed concern regarding the potential risk of losses and increased exposure to fraud for depository banks. They stated that the interim rule will expose depository banks that accept share drafts for deposit that are payable by a local credit union but payable through a nonlocal bank to additional risk because such share drafts would not have to be returned as expeditiously as local checks would normally be returned. The commenters indicated that most share drafts payable through a nonlocal bank would not be received by the depository bank before funds must be made available under the local availability schedule. Home Loan Savings Bank, Fort Wayne, Indiana, commented that "in the past, we have on many occasions, experienced inordinate delays of from 12 to 18 days in the return of local credit union share drafts payable through distant nonlocal banks."

Commenters argued that checks considered local for the purposes of determining availability should also be considered local for determining whether the checks are returned expeditiously. They recommended that the revised definition of paying bank be applied to the rules of Subpart C, in particular the expeditious return rules, as well as the availability rules of Subpart B. They noted that this would also reestablish the clear connection between the availability requirements

and the time required for a check to be cleared and returned. Commenters also suggested that the credit union on which the check is written should be responsible for any losses incurred. American Bankers Association, Washington, DC, stated:

To relieve the unfair risk imposed on banks in this situation, we strongly recommend that the Board extend the revised definition of paying bank to Subpart C relating to the collection of checks. The expeditious return standard should be determined by the location of the payor bank since that location determines whether a local or nonlocal check funds availability schedule applies.

Thirty-five commenters stated that the interim rule promotes delayed disbursement. They noted that the revised definition of paying bank is inconsistent with the Federal Reserve Board's proposal to restrict remote disbursement of teller's checks and the Board's overall efforts to discourage delayed disbursement.

Eight commenters recommended that the final rule authorize direct presentment to credit unions that use payable through checks. They indicated that, under direct presentment, depository banks would have the option of collecting payable through checks locally in those cases where local availability must be provided, and thus would generally learn if a check has not been paid prior to the time funds must be made available for withdrawal.

Twenty-five commenters favored requiring a credit union to use a local payable through bank. They noted that this requirement would reduce the risks to the depository bank by maintaining the clear link between the time it takes to collect and return a check and the time within which the depository bank must make the funds available to the depositor. They stated that if the credit unions want their checks to be treated as local they should be willing to use a local payable through bank. They also noted that this proposal would eliminate the operational problems created by the interim rule, by enabling depository banks to rely on the routing number encoded on the check to determine availability.

Miscellaneous issues. Twenty commenters discussed the additional disclosure requirements, with the majority of the commenters opposing them due to the added cost to the depository bank, which would be passed on to bank customers. These commenters also indicated that these extra notices would create additional confusion to their customers. Further, some commenters indicated that it was operationally difficult to provide the

added disclosures to their customers because of printing backlogs and quarterly versus monthly statements. The American Bankers Association indicated that the proposed disclosure requirement was generally an appropriate solution, but suggested additional language that would be applicable to those depository banks that give availability of funds for all checks within the local schedule. Finally, some commenters supported the time frame for disseminating the disclosures.

Eight commenters generally favored the bona fide error proposal, but most asked that additional clarification be provided in § 229.21(c). Some commenters requested that "safe harbor" procedures for determining whether a check is local or nonlocal be identified or examples given with respect to the type of procedure that would be considered reasonable. Further, other commenters believed the provision offered only limited protection and suggested additional language so that depository banks relying on the list of routing numbers of payable through banks compiled by the Federal Reserve would not be liable for related mistakes.

One commenter indicated that it will maintain records of any losses incurred as a result of the payable through amendment and suggested that the Federal Reserve and other banks monitor these matters carefully, so that appropriate action can be taken if losses reach an unacceptable level.

One commenter indicated that the interim amendment was not clear as to what type of checks, other than credit union share drafts, were covered by the amendment, and requested that a more precise identification be given.

One commenter was not in favor of the technical revisions to Regulation CC that were made to conform other provisions of the regulation to the payable through amendment. This commenter requested that the Federal Reserve retain or modify in different ways the provisions that contained references to the use of the routing number versus the actual location of the bank offering payable through checks.

Initial Regulatory Flexibility Analysis

The Regulatory Flexibility Act (12 U.S.C. 601-612) requires an agency to publish an initial regulatory flexibility analysis with any notice of proposed rulemaking. Two of the requirements of an initial regulatory flexibility analysis (12 U.S.C. 603(b)), a description of the reasons why action by the agency is being considered and a statement of the objectives of, and legal basis for, the proposed rule, are contained in the

supplementary material above. The proposed rules require no additional reporting or record-keeping requirements nor are there relevant federal rules that duplicate, overlap, or conflict with the proposed rule.

Another requirement for the initial regulatory flexibility analysis is a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply. The above supplementary material contains the Board's best estimates of the number of institutions that use payable through checks and that would therefore be affected by the proposed rules. Many of the affected institutions would be small entities, generally credit unions, however the Board does not have information on the sizes of all of the affected entities.

The Board has included in its proposal several alternative rules and is requesting comment on the cost and risk associated with each alternative for all affected entities, both large and small. The Board has not, however, proposed an exemption from coverage for small institutions that use payable through checks. The purpose of the proposed rules is to alleviate the operational difficulties and risk associated with the acceptance of payable through checks by depository banks. This purpose would be defeated if the rules did not apply to small institutions that use payable through checks because the operational and risk problems for their checks would remain.

List of Subjects in 12 CFR Part 229

Banks, Banking, Federal Reserve System.

For the reasons set out in the preamble, 12 CFR Part 229 is proposed to be 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. 100-88, 101 Stat. 552, 636, 12 U.S.C. 4001 *et seq.*

2. In § 229.36, the heading is revised, paragraphs (b)(3) and (b)(4) are revised, and new paragraphs (b)(5), (f), and (g) are added to read as follows:

§ 229.36 Presentment and issuance of checks.

* * * * *

(b) * * *
(3) At any branch or head office, if the bank is identified on the check by name without address;

(4) At a branch, head office, or other location consistent with the name and address of the bank on the check if the

bank is identified on the check by name and address; or

(5) In the case of a check that is payable by a bank and payable through another bank,

(i) At a location to which delivery is requested by the bank by which the check is payable;

(ii) At any branch or head office of the bank by which the check is payable, if that bank is identified by name without address;

(iii) At any branch, head office, or other location consistent with the name and address of the bank by which the check is payable, if that bank is identified on the check by name and address; or

(iv) At any location described in paragraphs (b)(1) through (b)(4) of this section for the bank through which the check is payable.

* * * * *

(e) [Reserved]

Alternative 1

(f) *Presentment of payable through checks.* A check that is payable by a bank and payable through another bank may be presented for payment at any of the locations set forth in paragraphs (b)(4) (i) through (iii) of this section unless the routing number of the bank through which the check is payable is associated with a location in the same check processing region as the depository bank, in which case the check may only be presented for payment at the location referred to in paragraph (b)(5)(iv) of this section.

Alternative 2

(f) *Presentment of payable through checks.* A check that is payable by a bank and payable through another bank may be presented for payment at any of the locations set forth in paragraph (b)(5) of this section.

Alternative 1

(g) *Issuance of payable through checks.* A bank that arranges for checks payable by it to be payable through another bank shall require that the routing number printed in magnetic ink characters on each check be associated with an address in the same check processing region as the bank by which the check is payable. This provision shall be effective [one year after its publication as a final rule], and after that date banks that use payable through arrangements must require their customers to use checks that meet the requirements of this provision.

Alternative 2

(g) *Issuance of payable through checks.* A bank that arranges for checks payable by it to be payable through another bank shall require that the following information be printed conspicuously on the face of each check:

- (1) The words "payable through" followed by the name and location of the payable through bank; and
- (2) The name, location, and nine-digit routing number of the bank by which the check is payable.

This provision shall be effective [one year after its publication as a final rule], and after that date banks that use payable through arrangements must require their customers to use checks that meet the requirements of this provision.

Alternative 3

(g) *Issuance of payable through checks.* A bank that arranges for checks payable by it to be payable through another bank shall require that:

- (1) The routing number printed in magnetic ink characters on each check be associated with an address in the same check processing region as the bank by which the check is payable; and
- (2) The following information is printed conspicuously on the face of the check:

- (i) The words "payable through" followed by the name and location of the payable through bank; and
- (ii) The name and location of the bank by which the check is payable.

This provision shall be effective [one year after its publication as a final rule], and after that date banks that use payable through arrangements must require their customers to use checks that meet the requirements of this provision.

3. In § 229.38, paragraph (d) is redesignated as paragraph (d)(1), a new heading is added to paragraph (d), and a new paragraph (d)(2) is added to read as follows:

§ 229.38 Liability.

(d) *Responsibility for certain aspects of checks—(1)*

(2) *Responsibility for payable through checks.* In the case of a check that is payable by a bank and payable through a paying bank located in a different check processing region than the bank by which the check is payable, the bank by which the check is payable is responsible for damages under paragraph (a) of this section to the extent that the check is not returned to the depository bank through the payable through bank as quickly as would have

been required had the bank by which the check is payable been the bank to which the check was sent for payment. Responsibility under this paragraph shall be treated as negligence of the bank by which the check is payable for purposes of paragraph (c) of this section.

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

a. The commentary on § 229.38 is amended by revising the second paragraph of paragraph (b), by adding a new paragraph (b)5, immediately after paragraph (b)4., and by adding new paragraphs (f) and (g).

Appendix E—Commentary

Section 229.38 Presentment and Issuance of Checks

(b) * * *
The paragraph specifies the locations at which checks are considered received by the paying bank. 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. If, however, the payable through check is payable by a bank and sent to that bank, the bank by which the check is payable is the paying bank.

5. If a check is payable by a bank and payable through another bank, the check is considered received by the paying bank upon delivery to any location described in paragraphs 1, 3, or 4 above for the bank by which the check is payable. If such a check is sent to the payable through bank for payment and therefore the payable through bank is the paying bank with respect to that check, it is also considered received by the paying bank upon delivery to any location described in paragraphs 1, 2, 3, or 4 above for the bank through which the check is payable.

(e) [Reserved]

Alternative 1

(f) *Presentment of payable through checks.* This paragraph authorizes a depository or collecting bank to present a check that is payable by a bank, and payable through another bank, directly to the bank by which the check is payable unless the check is payable through a local bank, in which case the check must be presented to the local payable through bank.

Alternative 2

(f) *Presentment of payable through checks.* This paragraph authorizes a depository or collecting bank to present a check that is payable by a bank, and payable through another bank, directly to the bank by which the check is payable. A bank may also present such a check to the payable through bank. Presentment of such checks may take

place at any of the locations set forth in § 229.38(b)(5).

Alternative 1

(g) *Issuance of payable through checks.* This paragraph provides that if a bank arranges for a check payable by it to be payable through another bank, that check must bear a routing number in its MICR line associated with an address at which presentment may be made in accordance with § 229.38(b) that is in the same check processing region as the bank by which the check is payable. Under this requirement, the check could bear the routing number of the bank by which it is payable or the routing number of a local payable through bank. The address associated with the routing number of the bank by which the check is payable could function as an intercept point from which the check could be forwarded to a nonlocal payable through bank.

This provision takes effect one year after its publication as a final rule. The bank by which these checks are payable is responsible for requiring its customers to meet the new requirements after the effective date.

If a payable through check does not meet the requirements of this paragraph, the bank by which the check is payable may be liable to the depository bank or others as provided in § 229.38. For example, a bank by which a payable through check is payable could be liable to a depository bank that suffers a loss, such as lost interest or liability under Subpart B, that would not have occurred had the check met the requirements of this paragraph. The bank by which the check is payable may be liable for additional damages if it fails to act in good faith.

Alternative 2

(g) *Issuance of payable through checks.* This paragraph requires that if a bank arranges for a check payable by it to be payable through another bank, that check must contain conspicuously on its face the name, location, and nine-digit routing number of the bank by which the check is payable and the legend "payable through" followed by the name and location of the payable through bank. The routing number need not be in the MICR line. The required information is presumed to be conspicuous if it is in a type not smaller than six-point type.

This provision takes effect one year after its publication as a final rule. The bank by which these checks are payable is responsible for requiring its customers to meet the new requirements after the effective date.

If a payable through check does not meet the requirements of this paragraph, the bank by which the check is payable may be liable to the depository bank or others as provided in § 229.38. For example, a bank by which a payable through check is payable could be liable to a depository bank that suffers a loss, such as lost interest or liability under Subpart B, that would not have occurred had the check met the requirements of this paragraph. The bank by which the check is payable may be liable for additional damages if it fails to act in good faith.

Alternative 3

(g) *Issuance of payable through checks.* This paragraph provides that if a bank arranges for a check payable by it to be payable through another bank, that check must bear a routing number in its MICR line associated with an address at which presentment may be made in accordance with § 229.36(b) that is in the same check processing region as the bank by which the check is payable. Under this requirement, the check could bear the routing number of the bank by which it is payable or the routing number of a local payable through bank. The address associated with the routing number of the bank by which the check is payable could function as an intercept point from which the check could be forwarded to a nonlocal payable through bank.

This paragraph also requires that if a bank arranges for a check payable by it to be payable through another bank, that check must contain conspicuously on its face the name, location, and nine-digit routing number of the bank by which the check is payable and the legend "payable through" followed by the name and location of the payable through bank. The routing number need not be in the MICR line. The required information is presumed to be conspicuous if it is in a type not smaller than six-point type.

This provision takes effect one year after its publication as a final rule. The bank by which these checks are payable is responsible for requiring its customers to meet the new requirements after the effective date.

If a payable through check does not meet the requirements of this paragraph, the bank by which the check is payable may be liable to the depository bank or others as provided in § 229.38. For example, a bank by which a payable through check is payable could be liable to a depository bank that suffers a loss, such as lost interest or liability under Subpart B, that would not have occurred had the check met the requirements of this paragraph. The bank by which the check is payable may be liable for additional damages if it fails to act in good faith.

* * * * *

b. The commentary on § 229.38 is amended by redesignating the first three paragraphs of paragraph (d) as paragraph (d)(1); by adding a heading for paragraph (d); by adding a new paragraph (d)(2) to follow the third paragraph of newly redesignated paragraph (d)(1); and by revising the last paragraph of paragraph (d) to read as follows:

Section 229.38 Liability

* * * * *

(d) *Responsibility for certain aspects of checks—(1)* * * *

(2) *Responsibility for payable through checks.* This paragraph provides that the bank by which a payable through check is payable will be liable for damages under paragraph (a) to the extent that the check is not returned through the payable through bank as quickly as would have been required under § 229.30 had the check been sent to the bank by which it is payable for payment. This responsibility does not include responsibility for the time required for the forward collection of a check.

Responsibility under paragraphs (d)(1) and (d)(2) is treated as negligence for comparative negligence purposes, and the contribution to damages under paragraphs (d)(1) and (d)(2) is treated in the same way as the degree of negligence under paragraph (c) of this section.

By order of the Board of Governors of the Federal Reserve System, October 25, 1988.

William W. Wiles,
Secretary of the Board.
[FR Doc. 88-25039 Filed 11-1-88; 8:45 am]
BILLING CODE 6210-01-M

12 CFR Part 229

[Regulation CC; Docket No. R-0649]

Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is proposing for comment several amendments to Regulation CC and its Commentary (Appendix E to Regulation CC). The regulation requires banks to make funds available to their customers within specified times, to disclose their funds availability policies to their customers, and to handle returned checks expeditiously. Since the publication of Regulation CC, the Board has received numerous requests from banks and others for clarification of various provisions of the regulation. The Board believes that the proposed changes to Regulation CC and its Official Commentary (Appendix E) respond to many of these questions and would aid banks in understanding and complying with the regulation.

DATE: Comments must be submitted on or before December 30, 1988.

ADDRESSES: Comments, which should refer to Docket No. R-0649, 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 5:15 p.m. All comments received at the above address will be made available to the public, and may be inspected at the Freedom of Information Office, Room B-1122 between 8:45 a.m. and 5:00 p.m.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202/452-3674) or Gayle Thompson, Program Leader (202/452-2934), Division of Federal Reserve Bank Operations; Joseph R. Alexander, Senior Attorney (202/452-2489) or Stephanie Martin,

Attorney (202/452-3198), Legal Division; Kathleen S. Brueger, Staff Attorney (202/452-2412) or Thomas J. Noto, Staff Attorney (202/452-3667), Division of Community and Consumer Affairs; or for the hearing impaired *only*, Telecommunications device, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: On May 13, 1988, the Board adopted Regulation CC (12 CFR Part 229) to carry out the provisions of the Expedited Funds Availability Act (12 U.S.C. 4001 *et seq.*), 53 FR 19372 (May 27, 1988). The regulation requires banks¹ to make funds available to their customers within specified times to disclose their funds availability policies to their customers, and to handle returned checks expeditiously. Since the publication of Regulation CC, the Board has received numerous requests from banks and others for clarification of various provisions of the regulation. The Board believes that the proposed changes to Regulation CC and its Official Commentary (Appendix E) respond to many of these questions and would aid banks in understanding and complying with the regulation.

The proposed amendments may be summarized as follows:

Section 229.2 Definitions.

(d) *Available for withdrawal.* The Commentary states that funds are considered to be available for withdrawal even though they cannot be used because they are subject to garnishment, tax levy, or court order restricting disbursements from the account. The Board proposes to amend the Commentary to make it clear that when a bank places a hold on funds or sets funds aside as a result of the certification of a check, a check guaranty, purchase of a cashier's check, or similar transaction, the bank has not failed to make funds available for withdrawal. This change would make it clear that banks are permitted under the regulation to place a hold on the funds represented by a check certified or purchased and not debit the account until the check is presented for payment.

(e) *Bank.* the Board proposes to amend the definition of "bank" by adding agencies of foreign banks that are located in the United States. The Expedited Funds Availability Act definition of "depository institution" includes "an office, branch, or agency of a foreign bank located in the United

¹ Regulation CC defines the term "bank" to include all depository institutions. 12 CFR 229.2(e).

States." 12 U.S.C. 4001(12). The definition of bank in Regulation CC originally included only branches of foreign banks as defined in the International Banking Act (12 U.S.C. 3101). In some cases, agencies of foreign banks, however, may hold accounts and pay checks. Accordingly, it is appropriate to cover agencies of foreign banks as well as branches. Other offices of foreign banks in the United States are not permitted to hold accounts. This amendment would become effective 120 days following its final adoption to provide agencies of foreign banks sufficient time to implement the requirements of Subpart B.

The Board also proposes to amend the Commentary to the definition of "bank" by clarifying the status of Edge Act corporations, agreement corporations, and commercial lending companies (such as banking companies incorporated under Article XII of the New York Banking Law) under the regulation. Congress did not include these corporations under the definition of "depository institution;" consequently, the Board did not subject them to the availability and disclosure requirements of Subpart B of Regulation CC. For purposes of Subpart C, however, the term "bank" also includes any person engaged in the business of banking. Edge Act corporations, agreement corporations, and commercial lending companies do pay checks and drafts and would generally be considered to be engaged in the business of banking. Therefore, the board proposes to amend the Commentary to clarify that Subpart C also applies to these entities.

(f) *Banking day* and (g) *Business day*. The commentary to these definitions states that deposits made to an ATM are considered made at the branch holding the account into which the deposit is made for the purpose of determining the day of deposit. The Board believes that it is appropriate to apply this rule to deposits made at off-premise facilities, such as remote depositories and lock boxes, as well as at ATMs. All other deposits should be considered made at the branch at which the deposit is received. The Board proposes to revise the Commentary accordingly.

(k) *Check*. The Commentary states that a credit card draft is not considered a check for purposes of the regulation. The Board proposes to clarify the term "credit card draft" by revising the Commentary to specify that the term includes sales drafts used by merchants or generated by banks, but excludes checks that banks provide to their

customers as a means of accessing credit lines without the use of credit cards.

(z) *Paying bank*. The definition of paying bank includes the state or unit of general local government on which a check is drawn. Some states and local governments issue drafts drawn on themselves, but designate the drafts as payable through or at a bank. The Board proposes to amend the definition of paying bank to provide that a state or unit of general local government is a paying bank only if the check is actually sent to the state or unit of general local government for payment or collection. A related amendment is proposed for the warranty provisions in § 229.34 (a) and (b).

(bb) *Qualified Return Check*. The regulation defines a qualified returned check ("QRC") as one that has been prepared for automated return to the depository bank by placing the check in a carrier envelope or placing a strip on the check and encoding the strip or envelope in magnetic ink. Under § 229.31(a), a returning bank's return deadline is extended by one business day if the returning bank converts a returned check to a QRC.

Under the current regulation, returning banks that might want to use another technology for automating returned check processing may not extend their return deadline when using a methodology other than that defined for a qualified returned check. A broader definition of qualified returned check would provide incentives for banks to develop other methods for automating returns that might be more efficient. If, however, the definition of qualified returned check were broadened to make various methods of automating the return of unpaid checks more acceptable, the likelihood that all banks involved in handling a given return will be using the same automated system is diminished, thus reducing the efficiency of any of the systems. Therefore, it might be desirable to continue the current restrictions on the use of alternative technologies.

The Board requests comment on whether banks need a broader definition of qualified returned checks to accommodate different technologies. For example, an alternative of the qualified returned checks, the "Speedy Return Plan," was issued for comment in December 1987 as part of longer-term initiatives for improving returned check processing. See 52 FR 47179 (December 11, 1987). This alternative program differs from the qualified returned check because it would use electronic files rather than envelopes or strips to direct

the returned check to the depository bank. Comments on this alternative method of automating returns indicated that it should be explored further.

In addition, the Board requests comment on whether banks would use an alternative method of qualifying returns if it were available and whether the number of alternative methodologies allowed should be limited. The Board also requests comment on whether a returning bank should be permitted to extend its return deadline by the additional day to prepare the return for processing using another technology if the return had originally been qualified by the paying bank.

In addition, the Board proposes to clarify the Commentary to indicate that QRCs prepared using envelopes preprinted with the return item identifier may conform to the guidelines established in *Specification for the Placement and Location of MICR Printing, X9.13* by the American National Standards Committee on Financial Services (Sept. 8, 1983) ("ANSI guidelines") for the external processing code ("EPC") field for printing the identifier. The ANSI guideline states that the EPC field is located within ¼ inch to the left of the routing number, thus allowing the identifier to be in either position 44 or position 45 on preprinted envelopes.

(cc) *Returning bank*. The definition of "returning bank" in Regulation CC states that a returning bank is a collecting bank for purposes of U.C.C. § 4-202(1)(e), which specifies a collecting bank's duty to notify its transferor of delays in transit. On further consideration, the Board does not believe that it is necessary for Regulation CC to require that a returning bank notify its transferor or any loss or delay in transit, and therefore proposes to delete this reference from the definition. A returning bank would still be a collecting bank for purposes of U.C.C. § 4-202(2), which sets out when a collecting bank's action would be considered to be seasonable.

(kk) *Unit of general local government*. The Board has been asked whether Indian nations are considered to be units of general local government within the meaning of Regulation CC. The Act provides next-day availability for checks drawn by a unit of general government. Under the Act, a unit of general local government is defined as any city, county, town, township, parish, village, or other general purpose political subdivision of a state. As Indian nations are not subdivisions of the states, Indian nations are not units of general local governments within the

meaning of the Act, and the Board consequently proposes to revise the Commentary to make it clear that Indian nations are not included within the meaning of this term.

Section 229.10 Next-day availability.

Certain check deposits. The Board proposes to clarify that banks are required to provide next-day availability (or two-day availability under § 229.10(c)(2)) only for those Federal Reserve Bank and Federal Home Loan Bank checks that are encoded with a routing number listed in Appendix A to the regulation. Bank generally must rely on the routing number to determine whether these checks are subject to next-day availability, because the banks cannot require the use of special deposit slips to identify them. The routing numbers assigned to the Federal Reserve Banks and Federal Home Loan Banks may change from time to time, and the Board does not believe that banks should be held liable for not providing next-day availability for a Federal Reserve Bank or Federal Home Loan Bank check that contains a newly issued routing number that has not yet been included in Appendix A. The Board will update Appendix A periodically to incorporate recently issued Federal Reserve Bank and Federal Home Loan Bank routing numbers.

The Board proposes to add a sentence to the Commentary to § 229.10 that points out that traveler's checks are also entitled to next-day availability when they are deposited to new accounts, cross-referencing the new account exception in § 229.13.

Deposits made to an employee of the depository bank. In most cases, § 229.10(c) conditions next-day availability on the check being deposited in person to an employee of the depository bank. Deposits made through the mail or at an ATM or night depository must be made available not later than the second business day after the banking day of deposit. Some questions have been raised about the meaning of the term "in person to an employee of the depository bank," e.g., does it cover situations where a bank sends a courier to the customer to pick up checks for deposit? The language used by the Act is "deposited in a receiving depository institution which is staffed by individuals employed by such institution," 12 U.S.C. 4002(a)(2), and the Act defines "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). The Board interprets these provisions as

requiring next-day availability only for deposits made to staff of the depository bank at a branch of the bank. Under § 229.10(c)(2), second-day availability would apply to deposits described in this section that are made at a teller station staffed by a person that is not an employee of the depository bank (e.g. a shared staffed teller facility located in a retail store), and to deposits picked up at the customer's premises by an employee of the depository bank. Accordingly, the Board proposes to revise this section of the Commentary to make these clarifications.

Fees for withdrawals. The Commentary to § 229.10(c) prohibits a depository bank from imposing a fee on a customer when the customer withdraws funds that must be made available under the regulation, but for which the bank has not yet received credit. The Board intended this provision to prevent practices designed to discourage customers from exercising their right to withdraw these funds in accordance with the regulation.

Banks have expressed concern, however, that this provision could be interpreted to prohibit the application of account analysis programs commonly used by banks under which interest or earnings credits are computed on the basis of collected balances. The Board believes that such programs are generally adopted for legitimate purposes and not for purposes of evading the requirements of the Act. Because of the difficulties in distinguishing these programs from devices to evade the requirements of the Act, the Board proposes to delete this provision of the Commentary. The Board, however, plans to monitor the practices of banks in this area, and may consider specific restrictions if it determines that abuses are occurring.

Special deposit slips. The regulation permits depository banks to require the use of special deposit slips as a condition to providing next-day availability for certain types of checks. Banks imposing this requirement must make the slips reasonably available to their customers. The Commentary states that if a bank only provides the special deposit slips upon the request of a customer, the bank's tellers must advise depositors of the special-slips' availability. Since the publication of the final rule, a number of banks have stated that this requirement places a difficult burden on tellers. The Board proposes to amend this portion of the Commentary by deleting the reference to the teller's duties.

Section 229.11 Temporary availability schedule.

(c) *Nonlocal checks.* Under the temporary schedule, funds deposited by nonlocal check must be made available for withdrawal no later than the seventh business day following the banking day of deposit. There are exceptions for deposits in accounts of banks located outside the 48 contiguous states and for deposits made to nonproprietary ATMs. The Board proposes to delete the reference to nonproprietary ATM deposits because § 229.11(d) already requires that all checks deposited at nonproprietary ATMs be made available no later than the seventh business day following the banking day of deposit.

Section 229.13 Exceptions.

(b) *Large deposits.* This provision permits a depository bank to extend the hold placed on local and nonlocal check deposits to the extent that the aggregate amount of the deposit on any banking day exceeds \$5,000. Since the final rule was adopted, several banks have asked if there is any rule that applies when a large-dollar deposit is made up of both local and nonlocal checks to determine which checks or portions of checks should be made available in accordance with the schedule and which checks may be held for a longer period of time under this exception. The Board intended to leave this determination to the discretion of the depository bank, and proposes to amend the Commentary to clarify this point.

(e)(2) *Overdraft and returned check fees.* The last sentence of this paragraph of the regulation states that "[t]he overdraft and returned check notice must state that the customer may be entitled to a refund of overdraft or returned check fees * * *." This sentence, when read with the notice requirement of § 229.13(g), could be interpreted to require banks to provide duplicate notices to their customers in certain cases. Thus, the Board proposes to amend the last sentence of this paragraph to clarify that only one notice is required.

Section 229.16 Specific availability policy disclosure.

The Board proposes to clarify two disclosure issues that have been raised since Regulation CC took effect. These clarifications would not require banks to change disclosures that have already been printed or mailed.

(a) *General.* The Board proposes two revisions to the Commentary to § 229.16(a). First, the Board would clarify that if a bank discloses the policy

it follows in most cases, it need not disclose to some customers that they may get faster availability. In addition, the Board would clarify that a bank does not violate the disclosure requirements of the regulation if it pays checks written on an account prior to the day funds in the account become available for withdrawal according to its disclosure. As long as funds are not available for withdrawal for all uses permitted to the customers, they are not "available for withdrawal" as that term is defined in the regulation and, generally, disclosures based on the time that funds are available for all uses are proper.

(b) *Content of specific availability policy disclosure.* The Board also proposes a revision to the Commentary to § 229.16(b) to clarify that a bank that provides availability based on when the bank generally receives credit for deposited checks need not disclose the time when a check drawn on each bank will be available for withdrawal. Instead, the bank may disclose the categories of deposits that must be available on the first business day after the day of deposit, state the other categories of deposits and the time periods that will be applicable to those deposits, and state that the customer may request a copy of the bank's schedule for when deposits of those checks will be available for withdrawal.

(c)(3) *Overdraft and returned check fees.* The last sentence of this paragraph of the regulation states that "[t]he overdraft and returned check notice must state that the customer may be entitled to a refund of overdraft or returned check fees * * *." This sentence, when read with the notice requirement in § 229.16(c)(2), could be interpreted to require banks to provide duplicate notices to their customers in certain cases. The Board proposes to amend the last sentence of this paragraph to read "[t]he notice must state that the customer may be entitled to a refund of overdraft or returned check fees * * *."

Section 229.19 Miscellaneous.

(a) *When funds are considered deposited.* This paragraph establishes rules to determine when funds are considered received in various circumstances. Rules applicable to deposits made at staffed teller stations differ from those that apply to deposits made at off-premises facilities, such as lock boxes or night depositories. The Board believes that the rule for when funds deposited in a deposit box located in the lobby of the bank should be similar to the rule for funds received at a

staffed teller station, and proposes to amend the Commentary accordingly.

Section 229.19(a)(5)(ii) permits a bank to establish a cut-off hour of 2:00 p.m. or later, after which deposits may be considered made on the following banking day. This provision is similar to U.C.C. § 4-107. Recognizing that many banks close before 2:00 p.m., the Commentary notes that this provision does not require banks to stay open until 2:00 p.m. The language in the Commentary has raised a number of questions, e.g., what is the effect of closing most of the bank but leaving drive-up teller windows open? The Board proposes to amend the Commentary to clarify the effect of closing practices on cut-off hours.

(e) *Holds on other funds.* Section 229.19(e) of the regulation limits the hold a depository bank may place on any funds of the customer due to a deposit to an account covered by the regulation. For example, for deposits made to a customer's checking account, if a bank places a hold on funds in a nontransaction account, such as certain savings accounts, rather than the customer's checking account, the bank may place such a hold only to the extent that the funds held do not exceed the amount of the deposit, and the length of the hold does not exceed the time periods permitted by the regulation. This restriction is intended to prevent evasion of a principal purpose of the Act, i.e., to limit holds on deposits to transaction accounts.

The regulation also limits holds that a bank can place on funds of the customer if the customer cashes a check over the counter to holds that do not exceed the time periods prescribed in the regulation and do not exceed the amount of the check cashed. A number of banks have argued that, as to checks cashed over the counter, this restriction is overly broad because cashing a check over the counter and placing a hold on a nontransaction account does not involve an "account" covered by the Act.

The Board proposes to amend § 229.19(e) so that, in the case of checks cashed over the counter, the regulation does not limit holds placed on funds that are not held in accounts as defined by the regulation.

Section 229.20 Relation to State law.

The Act (section 606, 12 U.S.C. 4007) provides that any state law in effect on or before September 1, 1989, that provides for a shorter hold for a category of checks than is provided under federal law will supersede the federal provision. Section 229.20 of the regulation provides for Board determinations, upon request, of

whether state law relating to the availability of funds is preempted by federal law and also provides certain preemption standards.

In August 1988 and October 1988, the Board adopted preemption determinations with respect to the laws of several states. See, for example, 53 FR 32359 (August 24, 1988). In formulating those preemption determinations, the Board adopted certain uniform principles that will apply in all Board preemption determinations. The Board proposes to amend the Commentary to § 229.20 of Regulation CC to incorporate these principles for preemption determinations.

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

(a) *Return of checks.* Prior to the effective date of Regulation CC, a paying bank usually returned a check to the presenting bank and automatically received a refund of any provisional settlement it may have made. Under Regulation CC, the paying bank must make an expeditious return, which may or may not involve returning the check through the presenting bank. If the paying bank does not return through the presenting bank, it will receive payment for the check from the bank to which the check is returned (a returning bank or the depository bank). In these cases, any credit given to the presenting bank is not charged back.

In rare cases, a paying bank that returns a check may not have settled for the check with the presenting bank. In such cases, if the paying bank returns the check other than through the presenting bank, it should be required to make immediate payment for the amount of the check to the presenting bank. The Board proposes to amend the Commentary to § 229.30(a) to clarify this point.

(b) *Unidentifiable depository bank.* If a paying bank is unable to identify the depository bank, it may return the check to any bank that handled the check for forward collection, even if that bank has not agreed to act as a returning bank. If a paying bank chooses this option, it must advise the collecting bank that it is unable to identify the depository bank. The Board proposes to amend the Commentary to provide that this notice must be conspicuous, and that the paying bank may not prepare the check for automated processing.

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

(b) *Unidentifiable depository bank.* This paragraph provides, among other things, that a returning bank that

receives a check from a paying bank that could not identify the depository bank must return the check expeditiously to the depository bank if it is able to identify the depository bank. The Board proposes to amend the regulation to clarify that this requirement also applies to checks that a returning bank receives from another returning bank where the prior returning bank is not able to identify the depository bank.

(f) *Notice in lieu of return.* This paragraph provides that a returning bank may send a notice of nonpayment in lieu of the physical check if the check is lost or otherwise unavailable. The Board does not believe that a check is unavailable merely because a bank has filed it in a way that makes its retrieval inconvenient or difficult. Notice in lieu of the return of the actual check should be permitted only when a bank does not have and cannot obtain possession of the check or must retain possession of the check for protest. The Board proposes an amendment to the Commentary to clarify this point.

Section 229.32 (Depository bank's responsibility for returned checks.

Under § 229.32(a)(2), a depository bank must accept returned checks at a location consistent with the name and address of the depository bank in its indorsement on the check, or, if no address appears in the indorsement, at a branch or head office associated with the routing number of the depository bank in its indorsement. A depository bank's indorsement could contain an address that is in a different check processing region from an address associated with the routing number in the indorsement. As returned checks will be routed on the basis of the routing number in the depository bank's indorsement, the return of checks will be facilitated if returns can be made to an address in the same check processing region as the location associated with the routing number. Therefore, the Board proposes to amend § 229.32(a)(2) to provide that if the address in the depository bank's indorsement is not in the same check processing region as the address associated with the routing number in its indorsement, the depository bank must accept returned checks at a branch or head office associated with the routing number in the indorsement.

Section 229.32(a) also permits depository banks to require that returned checks be sorted separately from forward collection checks. The intent of this provision is to require paying or returning banks to present returned checks to the depository bank

separately sorted from forward collection checks, unless the depository bank agrees to take returned checks commingled with forward collection checks. The Board proposes to clarify the regulation and the Commentary on this point.

Similarly, the Board also proposes to amend § 229.32 to state that a depository bank may require returned checks for which it is the depository bank to be separately sorted from checks for which it is a returning bank, including those for which it is a prior indorser. This amendment would facilitate the handling of checks that are returned to prior indorsers because of difficulty in identifying the depository bank.

Section 229.33 Notice of nonpayment.

(a) *Requirement.* A paying bank's failure to give notice of nonpayment may be offset by a depository bank's breach of warranty of title or other warranty regarding a check. The Board believes that a paying bank should not be responsible to a depository bank for failure to give notice in a case where the depository bank has breached its warranty, such as where the check has been stolen. This is consistent with the Uniform Commercial Code's allocation of loss for the late return of a check in such a case. See U.C.C. § 4-032; see also *First American Savings v. M & I Bank*, 685 F. Supp. 473 (E.D. Pa. 1988); 50 FR 5739-40 (Feb. 12, 1985). The Commentary to this section has been revised to clarify the notice of nonpayment requirement in such cases.

Section 229.35 Indorsements

(a) *Indorsement standards.* The indorsement standard specifies the information that must be included in a depository bank's indorsement. The standard also permits depository banks to include other identifying information in their indorsements. Some banks have included nine-digit ZIP codes in their indorsements. The Board believes that the inclusion of the nine-digit ZIP code could lead paying and returning banks to confuse the ZIP code with the routing number, which also contains nine digits. In order to prevent this confusion, the Board proposes to amend the Commentary to advise depository banks not to include in their indorsements information, such as a nine-digit ZIP code, that could be confused with required information, such as the depository bank's routing number.

(b) *Liability of bank handling check.* This paragraph provides that a bank handling a check for collection or return may have the rights of a holder. The Board proposes to revise the

Commentary to clarify that a bank may become a holder or a holder in due course regardless of whether prior banks have complied with the regulation's indorsement standards.

Section 229.37 Variation by agreement.

The Commentary to this section notes that the Board did not adopt the rule stated in U.C.C. section 4-103(2), which provides that Federal Reserve regulations and operating letters, clearinghouse rules, and the like have the effect of agreements under the U.C.C. that apply to parties that have not specifically assented to them. The Board did not, however, intend to affect the status of such agreements under the U.C.C., and the Board accordingly proposes to clarify this point in the Commentary.

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

The Board proposes to update the list of Federal Home Loan Bank routing numbers to include a newly-issued routing number of the Houston Branch of the Federal Home Loan Bank of Dallas.

Miscellaneous Amendments

In a related action today (Docket No. R-0648), the Board is proposing a number of substantive amendments to Regulation CC to alleviate the problems associated with treating checks payable by one bank but payable through another as local or nonlocal based on the location of the bank by which they are payable. Several other technical amendments are also necessary to accommodate cases where a check is payable by one bank but payable through another; these include amendments to § 229.34 (Warranties by paying bank and returning bank) and § 229.38 (Liability) to clarify that in cases of payable through drafts payable by a bank, the bank by which the check is payable, not the payable through bank, makes the paying bank's warranties or is liable for the condition of the back of a check. These proposed technical amendments related to payable through checks are included in this notice.

Initial Regulatory Flexibility Act Analysis

These proposals are primarily clarifications to Regulation CC that the Board is proposing in response to questions and requests for clarification that the Board has received since the final rule was adopted. The Board does not believe that adoption of the

proposals will result in any significant economic impact on a substantial number of small entities.

List of Subjects in 12 CFR Part 229

Banks, Banking, Federal Reserve System.

For the reasons set out in the preamble, 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 of 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 (e)(7), (z)(5), and (cc) are revised to read as follows:

§ 229.2 Definitions.

(e) "Bank" means—

(7) An "agency" or a "branch" of a "foreign bank" as defined in section 1(b) of the International Banking Act (12 U.S.C. 3101).

(z) "Paying bank" means—

(5) The state or unit of general local government on which a check is drawn and to which it is sent for payment or collection.

(cc) "Returning bank" means a bank (other than the paying or depositary bank) handling a returned check or notice in lieu of return. A returning bank is also a collecting bank for purposes of U.C.C. § 4-202(2).

3. In § 229.13, paragraph (e)(2) is revised to read as follows:

§ 229.13 Exceptions.

(e)(2) *Overdraft and returned check fees.* * * * The notice must state that the customer may be entitled to a refund of overdraft or returned check fees that are assessed if the check subject to the exception is paid and how to obtain a refund.

4. In § 229.16, paragraph (c)(3) is revised to read as follows:

§ 229.16 Specific availability policy disclosure.

(c)(3) *Overdraft and returned checks.* The notice must state that the customer may be entitled to a refund of overdraft or returned check fees that are assessed

if the check subject to the delay is paid and state how to obtain a refund.

5. In § 229.19, paragraph (e) is revised to read as follows:

§ 229.19 Miscellaneous.

(e) *Holds on other funds.* (1) A depositary bank that receives a check for deposit in an account may not place a hold on any funds of the customer at the bank, where—

(i) The amount of funds that are held exceeds the amount of the check; or

(ii) The funds are not made available for withdrawal within the times specified in §§ 229.10, 229.11, 229.12, and 229.13.

(2) A depositary bank that cashes a check for a customer over the counter, other than a check drawn on the depositary bank, may not place a hold on funds in an account of the customer at the bank, if—

(i) The amount of funds that are held exceeds the amount of the check; or

(ii) The funds are not made available for withdrawal within the times specified in §§ 229.10, 229.11, 229.12, and 229.13.

6. In § 229.31, the last sentence of paragraph (b) is revised to read as follows:

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

(b) Unidentifiable depositary bank.

(2) * * * A returning bank that receives a returned check from a paying bank under § 229.30(b), or from a returning bank under this paragraph, but which is able to identify the depositary bank, must thereafter return the check expeditiously to the depositary bank.

7. In § 229.32:

a. Paragraph (a)(2)(ii) is revised to read as follows:

§ 229.32 Depositary bank's responsibility for returned checks.

(a) * * *

(2) * * *

(ii) If no address appears in the indorsement, or if the address in the indorsement is not in the same check processing region as the address associated with the routing number of the bank in its indorsement on the check, at a branch or head office associated with the routing number in the bank's indorsement; or

b. The last sentence of paragraph (a) is revised to read as follows: "A

depositary bank may require returned checks to be separated from forward collection checks and returned checks for which the bank is depositary bank to be separated from checks for which it is a returning bank (including those for which it is a prior indorser)."

8. In § 229.34, paragraph (a)(1), the undesignated paragraph following paragraph (a)(4), paragraph (b)(1), and the undesignated paragraph after (b)(3) are revised to read as follows:

§ 229.34 Warranties by paying and returning bank.

(a) *Warranties.* * * *

(1) The paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, returned the check within its deadline under the U.C.C., Regulation J (12 CFR Part 210), or § 229.30(c) of this part * * *

These warranties are not made with respect to checks drawn on the Treasury of the United States, U.S. Postal Service money orders, or checks drawn on a state or a unit of general local government that are not payable through or at a bank.

(b) *Warranty of notice of nonpayment.* * * *

(1) The paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, returned or will return the check within its deadline under the U.C.C., Regulation J (12 CFR Part 210), or § 229.30(c) of this part; * * *

These warranties are not made with respect to checks drawn on a state or a unit of general local government that are not payable through or at a bank.

9. In § 229.35(d), the first sentence is amended to read as follows:

§ 229.35 Liability.

(d) *Responsibility for back of check.* A paying bank is responsible for damages under paragraph (a) of this section to the extent that the condition of the check when issued by it, its customer, or, in the case of a check payable through the paying bank, the bank (or customer of the bank) by which the check is payable, adversely affects that ability of a bank to indorse the check legibly in accordance with § 229.35. * * *

Appendix A—[Amended]

10. Appendix A is amended by adding a new routing number to the list, under

the heading *Federal Home Loan Banks*, in numerical order, as follows:

* * * * *

1130 1750 8

Appendix E—[Amended]

11. Appendix E—Commentary to Part 229 is amended as set forth below:

a. The Commentary to § 229.2(d) last sentence of the second paragraph, (e) second paragraph, (k) last paragraph, and (cc) is revised; in (f) and (g) a new sentence is added at the end of the second paragraph; in (bb) two new sentences are added at the end of the first paragraph; and a new Commentary to § 229.2(kk) is added as follows:

Section 229.2 Definitions

* * * * *

(d) *Available for withdrawal.* * * *
* * * For purposes of this regulation, funds are considered available for withdrawal even though they cannot be withdrawn because they are subject to garnishment, tax levy, or court order restricting disbursements from the account, or because the bank has set aside the funds as the result of the certification of a check, sale of a cashier's or teller's check, or guaranty or acceptance of a check.

(e) *Bank.* * * *
"Bank" is defined to include depository institutions, such as commercial banks, savings banks, savings and loan associations, and credit unions as defined in the Act, and U.S. branches and agencies of foreign banks. For purposes of Subpart B, the term does not include corporation organized under section 25(a) of the Federal Reserve Act, 12 U.S.C. 611-631 (Edge corporations) or corporations having an agreement or undertaking with the Board under section 25 of the Federal Reserve Act, 12 U.S.C. 601-604a (agreement corporations). For purposes of Subpart C, and in connection therewith, Subpart A, any Federal Reserve Bank, Federal Home Loan Bank, or any other person engaged in the business of banking is regarded as a bank. The phrase "any other person engaged in the business of banking" is derived from U.C.C. § 1-201(4), and is intended to cover entities that handle checks for collection and payment, such as Edge and agreement corporations, commercial lending companies under 12 U.S.C. 3101, certain industrial banks, and private bankers, so that virtually all checks will be covered by the same rules for forward collection and return, even though they may not be covered by the requirements of Subpart B. For the purposes of Subpart C, and in connection therewith, Subpart A, the term may also include states and units of general local government to the extent that they pay warrants or other drafts drawn directly on the State or local government itself.

(f) *Banking day* and (g) *Business day.* * * *

* * * A deposit made at an ATM or off-premise facility (such as a remote depository or a lock box) is considered made at the branch holding the account into which the

deposit is made for purposes of determining the day of deposit. All other deposits are considered made at the branch at which the deposit is received.

* * * * *

The definition of check does not include an instrument payable in a foreign currency (i.e., other than the United States money as defined in 31 U.S.C. 5101) or a credit card draft (i.e., a sales draft used by a merchant or a draft generated by a bank as a result of a case advance; "credit card draft" does not include a check that a bank may supply to a customer as a means of accessing a credit line without the use of a credit card).

(bb) *Qualified Returned Check (QRC).* * * *

* * * Banks using preprinted envelopes for qualifying returns may place the return identifier according to the ANSI X9.13 guidelines for the external processing code ("EPC") field, which allows placement within 1/4 inch to the left of the routing number field. This area would include position 45 as well as position 44.

(cc) *Returning bank* is defined to mean any bank (excluding the paying bank and the depository bank) handling a returned check. A returning bank may or may not be a bank that handled the returned check in the forward collection process. A returning bank includes a bank that agrees to handle a returned check for expeditious return to the depository bank under § 229.31(a). A returning bank is also a collecting bank for the purpose of a collecting bank's duty to act seasonably under U.C.C. § 4-202(2).

(kk) *Unit of general local government* is defined to include a city, county, parish, town, township, village, or other general purpose political subdivision of a state. The term does not include special purpose units, such as school districts, water districts, or Indian nations.

Section 229.10 [Amended]

b. The Commentary to § 229.10 is amended as follows:

1. Revising the last sentence in the first paragraph and adding a sentence to the end of the first paragraph of paragraph (c).

(c) *Certain check deposits.* * * * For the purposes of this section, all checks drawn on a Federal Reserve Bank or a Federal Home Loan Bank that contain in the MICR line a routing number that is listed in Appendix A are subject to the next-day availability requirement if they are deposited in an account held by a payee of the check and in person to an employee of the depository bank, regardless of the purposes of which the checks were issued. For all new accounts, even if the new account exception is not invoked, the first \$5,000 of traveler's checks, as well as checks described in this paragraph, deposited on any one banking day is subject to the

next-day availability requirement. (See § 229.13(a).)

ii. Revising the heading "Deposit at Staffed Teller Station" and the first paragraph under that heading to read as follows:

Deposits Made to an Employee of the Depository Bank

In most cases, next-day availability of the proceeds of checks subject to this section is conditioned on the deposit of these checks in person to an employee of the depository bank. If the deposit is not made to an employee of the depository bank on the premises of such bank, the proceeds of the deposit must be available for withdrawal by the start of business on the second business day after deposit, under paragraph (c)(2) of this section. For example, second-day availability rather than next-day availability would be allowed for deposits of checks subject to this section made at a proprietary ATM (and at a nonproprietary ATM under the permanent schedule), night depository, through the mail or a lock box, or at a teller station staffed by a person that is not an employee of the depository bank. Second-day availability may also be allowed for such deposits picked up by an employee of the depository bank at the customer's premises.

iii. Removing the heading "Fees for Withdrawals" and the paragraph appearing under it.

iv. In the fifth paragraph under the heading "Special Deposit Slips," removing the second sentence.

c. The Commentary to § 229.11(c) is amended by revising the first sentence to read as follows:

Section 229.11 Temporary Availability Schedule

* * * * *

(c) *Nonlocal checks.* Under the temporary schedule, funds deposited by nonlocal checks must be made available for withdrawal not later than the seventh business day following the banking day the funds are deposited, except in the case of deposits in accounts of banks located outside the 48 contiguous states. * * *

d. The Commentary to § 229.13(b) is amended by adding a new sentence after the second sentence of the first paragraph as follows:

Section 229.13 Exceptions

(b) * * * When the large deposit exception is applied to deposits composed of both local and nonlocal checks, the depository bank has the discretion to choose the portion of the deposit to which it applies the exception. * * *

Section 229.16 [Amended]

e. The Commentary to § 229.16(a) is amended by adding the following new paragraphs to the end thereof:

(a) * * *

The disclosure must reflect the policy and practice of the bank regarding availability as to most accounts and most deposits into those accounts. In disclosing the availability policy that it follows in most cases, a bank may provide a single disclosure that reflects one policy for all its transaction account customers, even though some of its customers may receive faster availability than that reflected in the policy disclosure. Thus, a bank need not disclose to some customers that they receive faster availability than indicated in the disclosure. If, however, a bank has a policy of imposing delays in availability or any customers longer than those specified in its disclosure, those customers must receive disclosures that reflect the longer applicable availability periods.

A bank may disclose that funds are "available for withdrawal" on a given day notwithstanding the fact that the bank uses the funds to pay checks received before that day. For example, a bank may disclose that its policy is to make funds available from deposits of local checks on the third business day following the day of deposit even though it may use the deposited funds to pay checks prior to the third business day; the funds used to pay checks in this example are not available for withdrawal until the third business day after deposit because the funds are not available for all uses until the third business day. (See the definition of "available for withdrawal" in § 229.2(d).)

f. The Commentary to § 229.16(b) is amended by adding the following new paragraph to the end thereof:

(b) * * *

A bank that provides availability based on when the bank generally receives credit for deposited checks need not disclose the time when a check drawn on a specific bank will be available for withdrawal. Instead, the bank may disclose the categories of deposits that must be available on the first business day after the day of deposit (deposits subject to § 229.10), and state the other categories of deposits and the time periods that will be applicable to those deposits. For example, a bank might disclose the routing number for local checks and indicate that such checks as well as certain nonlocal checks will be available for withdrawal on the first or second business day following the day of deposit, depending on the location of the particular bank on which the check is drawn, and disclose that funds from all other checks will be available on the second or third business day. The bank must also disclose that the customer may request a copy of the bank's detailed schedule that would enable the customer to determine the availability of any check, and must provide such schedule upon request.

Section 229.19[Amended]

g. The Commentary to § 229.19(a) is amended by

i. Revising the third sentence of the first paragraph to read as follows:

(a) * * * For example, funds received at a staffed teller station, a deposit box located in

a bank lobby, or an ATM are considered deposited when received by the teller or placed in the lobby deposit box or ATM. * * *

ii. Removing the last sentence of the last paragraph and adding a new paragraph at the end thereof to read as follows:

A bank is not required to remain open until 2:00 p.m. If a bank closes before 2:00 p.m., deposits received after the closing may be considered received on the next banking day. Further, as § 229.2(f) defines the term "banking day" as the portion of a business day on which a bank is open to the public for substantially all of its banking functions, a day, or a portion of a day, is not necessarily a banking day merely because the bank is open for only limited functions, such as keeping drive-in or walk-up teller windows open, when the rest of the bank is closed to the public. For example, a banking office that usually provides a full range of banking services may close at 12:00 noon but leave a drive-in teller window open for the limited purpose of receiving deposits and making cash withdrawals. Under those circumstances, the bank is considered closed and may consider deposits received after 12:00 noon as having been received on the next banking day. The fact that a bank may reopen for substantially all of its banking functions after 2:00 p.m., or that it continues its back office operations throughout the day, would not affect this result. A bank may not, however, close individual teller stations and reopen them for next-day's business before 2:00 p.m. during a banking day.

h. The Commentary to § 229.19(e) is amended by revising the second paragraph and adding a third paragraph to read as follows:

(e) *Holds on other funds.* * * *

This paragraph clarifies that, if a customer deposits a check in an account (as defined in § 229.2(a)), the bank may not place a hold on any of the customer's funds so that the funds that are held exceed the amount of the check deposited, or the total amount of funds held are not made available for withdrawal within the times required in this subpart. For example, if a bank places a hold on funds in a customer's nontransaction account, rather than a transaction account for deposits made to the customer's transaction account, the bank may place such a hold only to the extent that the funds held do not exceed the amount of the deposit, and the length of the hold does not exceed the time periods permitted by this regulation.

These restrictions also apply to holds placed on funds in a customer's account (as defined in § 229.2(a)), if a customer cashes a check (other than an "on us" check) over the counter. The regulation does not prohibit holds that may be placed on other funds of the customer for checks cashed over the counter, to the extent that the transaction does not involve a deposit to an account.

l. The Commentary to § 229.20(c) is revised to read as follows:

Section 229.20 Relation to State Law

* * * * *

(c) *Standards for preemption.* This section describes the standards the Board will use in making determinations on whether federal law will preempt state laws governing funds availability. A provision of state law is considered inconsistent with federal law if it permits a depository bank to make funds available to a customer in a longer period of time than the maximum period permitted by the Act and this regulation. For example, a state law that permits a hold of four business days or longer for local checks permits a hold that is longer than that permitted under the Act and this regulation, and therefore is inconsistent and preempted. State availability schedules that provide for availability in a shorter period of time than required under Regulation CC supersede the federal schedule.

Under a state law, some categories of deposits could be available for withdrawal sooner or later than the time required by this subpart, depending on the composition of the deposit. For example, the Act and this regulation (§ 229.10(c)(1)(vii)) require next-day availability for the first \$100 of the aggregate deposit of local or nonlocal checks on any day, and a state law could require next-day availability for any check of \$100 or less that is deposited. Under the Act, if either one \$150 check or three \$50 checks are deposited on a given day, \$100 must be made available for withdrawal on the next business day, and \$50 must be made available in accordance with the local or nonlocal schedule. Under the state law, however, the two deposits would be subject to different availability rules. In the first case, none of the proceeds of the deposit would be subject to next-day availability; in the second case, the entire proceeds of the deposit would be subject to next-day availability. In this example, because the state law would, in some situations, permit a hold longer than the maximum permitted by the Act, this provision of state law is inconsistent and preempted in its entirety.

In addition to the differences between state and federal availability schedules, a number of state laws contain exceptions to the state availability schedules that are different from those provided under the Act and this regulation. The state exceptions continue to apply only in those cases where the state schedule is shorter than or equal to the federal schedule, and then only up to the limit permitted by the Regulation CC schedule. Where a deposit is subject to a state exception under a state schedule that is not preempted by Regulation CC and is also subject to a federal exception, the hold on the deposit cannot exceed the hold permissible under the federal exception in accordance with Regulation CC. In such cases, only one exception notice is required, in accordance with § 229.19(g). This notice need only include the applicable federal exception as the reason the exception was invoked. For those categories of checks for which the state schedule is preempted by the federal schedule, only the federal exceptions may be used.

State law that provide maximum availability periods for categories of deposits that are not covered by the Act would not be

preempted. Thus, state funds availability law that apply to funds in time and savings deposits are not affected by the Act or this regulation. In addition, the availability schedules of several states apply to "items" deposited to an account. The term "items" may encompass deposits, such as nonnegotiable instruments, that are not subject to the Regulation CC availability schedules. Deposits that are not covered by Regulation CC continue to be subject to the state availability schedules. State laws that provide maximum availability periods for categories of institutions that are not covered by the Act would also not be preempted. For example, a state law that governs money market mutual funds would not be affected by the Act or this regulation.

Generally, state rules governing the disclosure or notice of availability policies applicable to accounts are also preempted, if they are different from the federal rules. Nevertheless, a state law requiring disclosure of funds availability policies that apply to deposits other than "accounts," such as savings or time deposits, are not inconsistent with the Act and this subpart. Banks in these states would have to follow the state disclosure rules for these deposits.

Section 229.30 [Amended]

j. The Commentary to § 229.30(a) is amended by adding to the end of the third paragraph after the fourth numbered example the following new sentence:

(a) *Return of checks.* * * *
Examples

4. * * *
* * * If a paying bank returns a check on its banking day of receipt without paying for the check, as permitted under U.C.C. § 4-302(a), and receives settlement for the returned check from a returning bank, it must promptly pay the amount of the check to the collecting bank from which it received the check.

k. The Commentary to § 229.30(b) is amended by:

i. Revising the fourth sentence of the second paragraph and, immediately after it, adding a new sentence to read as follows:

(b) *Unidentifiable depositary bank.* * * *
* * * A paying bank returning a check under this paragraph to a bank that has not agreed to handle the check expeditiously must advise that bank that it is unable to identify the depositary bank. This advice must be conspicuous, and the returned check may not be prepared for automated return.

ii. Revising the first sentence of the third paragraph to read as follows:

The sending of a check to a bank that handled the check for forward collection under this paragraph is not subject to the

requirements for expeditious return by the paying bank. * * *

Section 229.31 [Amended]

l. The Commentary to § 229.31(b) is amended by:

i. Revising the last sentence of the first paragraph to read as follows:

(b) *Unidentifiable depositary bank.* * * *
In the limited cases where the returning bank cannot identify the depositary bank, the returning bank may send the returned check to a returning bank that agrees to handle the returned check for expeditious return under § 229.31(a), or it may send the returned check to a bank that handled the check for forward collection even if that bank does not agree to handle the returned check expeditiously under § 229.31(a).

ii. Revising the last paragraph to read as follows:

As in the case of a paying bank returning a check under § 229.30(b), a returning bank that sends a check to a collecting bank under this paragraph must advise the collecting bank that the returning bank is unable to identify the depositary bank, and the advice must be conspicuous.

m. The Commentary to § 229.31(f) is amended by adding a new sentence before the parenthetical phrase to read as follows:

(f) *Notice in lieu of return.* * * * Notice in lieu of return is permitted only when a bank does not have and cannot obtain possession of the check or must retain possession of the check for protest. A check is not unavailable for return if it is merely difficult to retrieve from a filing system. * * *

Section 229.32 [Amended]

n. The Commentary to § 229.32(a) is amended by:

i. Adding to item 2(ii) two new sentences to be inserted immediately after the first sentence to read as follows:

(a) * * *
2. * * *
(ii) * * * The depositary bank must also accept returned checks at an address associated with its routing number in the indorsement if the written address in the indorsement and the address associated with the routing number in the indorsement are not in the same check processing region. Under §§ 229.30(g) and 229.31(g), a paying or returning bank may rely on the depositary bank's routing number in its indorsement in handling returned checks and is not required to send returned checks to an address in the depositary bank's indorsement that is not in the same check processing region as the address associated with the routing number in the indorsement.

ii. Adding a new sentence at the end of the last paragraph and adding a new last paragraph to read as follows:

(a) * * *

2. * * *
(iii) * * *

* * * In addition, a bank may require returned checks for which it is the depositary bank be separated from returned checks for which it is a returning bank (including for which the bank is a prior indorser).

Under § 229.33(d), a depositary bank receiving a returned check or notice of nonpayment must notify its customer by its midnight deadline, or within a longer reasonable time.

o. The Commentary to § 229.33(a) is amended by adding at the end thereof the following new paragraph:

Section 229.33 Notice of Nonpayment

(a) *Warranty of returned check.* * * *
A paying bank is not responsible for failure to give notice of nonpayment to a party that has breached a presentment warranty under the Uniform Commercial Code. See U.C.C. §§ 4-207(1) and 4-302.

p. The Commentary to § 229.34(a) is amended by revising the first and last sentence thereof to read as follows:

Section 229.34 Warranties by Paying Bank and Returning Bank

(a) *Warranty of returned checks.* This paragraph includes warranties that a returned check, including a notice in lieu of return, was returned by the paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, within the deadline under the U.C.C., Regulation J, or § 229.30(c); that the paying or returning bank is authorized to return the check; that the returned check has not been materially altered; and that, in the case of notice in lieu of return, the original check has not and will not be returned. * * * These warranties do not apply to checks drawn on the United States Treasury, to Postal Service money orders, or to checks drawn on a state or a unit of general local government that are not payable through or at a bank (see § 229.42).

Section 229.35 [Amended]

q. The Commentary to § 229.35(a) is amended by adding at the end of the fourth paragraph two sentences and in the fifth paragraph revising the first two sentences to read as follows:

* * * Depositary banks should not include information that can be confused with required information. For example, a nine-digit ZIP code could be confused with the nine-digit routing number.

A depositary bank is not required to place a street address in its indorsement; however, a bank may want to put an address in its indorsement in order to limit the number of locations at which it must accept returned checks and, in instances where this address is not consistent with the routing number in the indorsement, the depositary bank is required to accept returned checks at a branch or head office consistent with the routing number. Banks should note, however, that § 229.32 requires a depositary bank to

accept returned checks at the location(s) it accepts forward collection checks. * * *

r. The Commentary to § 229.35(a) is amended by adding the following sentence to the end of the last paragraph to read as follows:

* * * The standard requires collecting and returning banks to indorse the check for tracing purposes.

s. The Commentary to § 229.35(b) is amended by adding the following new paragraph after the fifth paragraph to read as follows:

(b) *Liability of bank handling check.* * * *

This paragraph also provides that a bank may have the rights of a "holder" based on the handling of the check for collection or return. A bank may become a holder or a holder in due course regardless of whether prior banks have complied with the indorsement standard in § 229.35(a) and Appendix D.

Section 229.37 [Amended]

t. The Commentary to § 229.37 is amended by

i. Revising the second sentence of the first paragraph to read as follows:

* * * To achieve consistency, the official comment to U.C.C. § 4-103(1) (which in turn follows U.C.C. § 1-201(3)) should be followed in construing this section. * * *

ii. Revising the second paragraph to read as follows:

The Board has not followed U.C.C. § 4-103(2), which permits Federal Reserve regulations and operating letters, clearinghouse rules, and the like to apply to parties that have not specifically assented. Nevertheless, this section does not affect the status of such agreements under the Uniform Commercial Code.

u. In the commentary to § 229.38(d), the first two sentences of the second paragraph are amended to read as follows:

(d) *Responsibility for back of check.* * * *

The paying bank is responsible for the condition of the check when it is issued by it, its customer, or, in the case of a check payable through the paying bank, the bank (or customer of the bank) by which the check is payable. (It would not be responsible for a check issued by a person other than such a bank or customer.) * * *

By order of the Board of Governors of the Federal Reserve System, October 25, 1988.

William W. Wiles,

Secretary of the Board.

[FR Doc. 88-25035 Filed 11-1-88; 8:45 am]

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12 CFR Part 229

[Regulation CC; Docket No. R-0647]

Availability of Funds and Collection of Checks; Preemption Determinations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed interpretations.

SUMMARY: The Board is publishing for comment a proposed official Board interpretation concerning a preemption determination under its Regulation CC, Availability of Funds and Collection of Checks, with respect to the law of New Jersey. The Expedited Funds Availability Act provides standards for determining whether State law governing funds availability supersedes, or is preempted by Federal law. Under Regulation CC, the Board with issue preemption determinations with respect to State law upon request.

DATES: Comments must be submitted on or before November 30, 1988.

FOR FURTHER INFORMATION CONTACT: Oliver Ireland, Associate General Counsel (202/452-3625), Legal Division, or Louise L. Roseman, Assistant Director (202/452-3874), Division of Federal Reserve Bank Operations; for the hearing impaired *only*: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

On May 13, 1988, the Board adopted Regulation CC to carry out the provisions of the Expedited Funds Availability Act (the "Act") (12 U.S.C. 4001-4010). The regulation requires banks to make funds available to their customers within specified time frames, and to disclose their funds availability policies to their customers. A number of states have also enacted rules governing funds availability. The Act (section 608) and Regulation CC (§ 229.20) provide that any provision of state law in effect on or before September 1, 1989, that provides for a shorter hold for a category of checks than is provided under federal law will supersede the federal provision.

Provisions of state law governing funds availability that permit a bank to make funds available for withdrawal in a longer period than permitted under Regulation CC are considered inconsistent, and are preempted by Regulation CC. In addition, state disclosure and notice requirements concerning funds availability related to accounts covered by Regulation CC are

preempted by the federal disclosure scheme.

Regulation CC provides for Board determinations of whether state law related to the availability of funds is preempted by federal law upon the request of a state, bank, or other interested party.

Discussion

The Board is publishing, for a 30-day public comment period, a proposed preemption determination with respect to New Jersey law. The Board set out principles, at the time it adopted several final state preemption determinations in August, as guides for future preemption determinations 53 FR 32354. Those principles have been followed in this proposed determination as well.

The State of New Jersey Department of Banking requested that the Board issue a preemption determination under Regulation CC with respect to New Jersey law. New Jersey does not have a law or regulation establishing maximum time periods within which funds deposited to accounts must be made available for withdrawal. New Jersey does, however, have regulations governing the disclosure of an institution's availability policy. Regulation CC provides that state funds availability disclosure or notice requirements applicable to accounts covered by the federal rules are preempted by the federal disclosure scheme. The Board is publishing for public comment the following proposed determination preempting New Jersey's disclosure regulations.

List of Subjects in 12 CFR Part 229

Banks, Banking, Federal Reserve System.

For the reasons set out in the preamble, 12 CFR Part 229 is proposed to be amended as follows:

PART 229—[AMENDED]

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

Authority: Title VI of Pub. L. 100-86, 101 Stat. 522, 635, 12 U.S.C. 4001 *et seq.*

2. Appendix F is amended by adding a preemption determination for the state of New Jersey alphabetically to read as follows:

Appendix F—Official Board Interpretations; Preemption Determinations

* * * * *

New Jersey

Background

The Board has been requested, in accordance with § 229.20(d) of Regulation CC (12 CFR Part 229), to determine whether the Expedited Funds Availability Act (the "Act") and Subpart B (and in connection therewith, Subpart A) of Regulation CC preempt the provisions of New Jersey law concerning disclosure of a bank's funds availability policy. (See also the Board's preemption determination regarding the Uniform Commercial Code, § 4-213(5), pertaining to availability of cash deposits.)

New Jersey does not have a law or regulation establishing the maximum time periods within which funds deposited by check or electronic payment must be made available for withdrawal. New Jersey does, however,

have regulations concerning the disclosure of a banking institution's availability policy (N.J.A.C. 3:1-15.1 *et seq.*).

Disclosures

New Jersey law requires every banking institution (defined as any state or federally chartered commercial bank, savings bank, or savings and loan association) to provide written disclosure to all holders of and applicants for deposit accounts which describes the institution's funds availability policy. Institutions must also disclose to their customers any significant changes to their availability policy.

Regulation CC preempts state disclosure requirements concerning funds availability that relate to "accounts" that are inconsistent with the federal requirements. The state

requirements are different from, and therefore inconsistent with, the federal disclosure rules. (§ 229.20(c)(2)). Thus, the New Jersey statute (N.J.A.C. §§ 3:1-15.1 *et seq.*) is preempted by Regulation CC to the extent that these disclosure provisions apply to "accounts" as defined by Regulation CC. The New Jersey disclosure rules would continue to apply to other "deposit accounts," as defined by New Jersey law, including money market accounts and savings accounts established by a natural person for personal or family purposes, which are not governed by the Regulation CC disclosure requirements.

By order of the Board of Governors of the Federal Reserve System, October 25, 1988.

William W. Wiles,

Secretary of the Board.

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