

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 10350]
June 11, 1990]

FUNDS TRANSFERS UNDER UCC ARTICLE 4A
Proposed Revision of Subpart B of Regulation J
Comment Invited by August 6

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

The following statement has been issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has issued for public comment a proposed comprehensive revision to Subpart B of Regulation J, governing funds transfers through Fedwire. The proposed revision would make Regulation J consistent with the new Article 4A of the Uniform Commercial Code, which governs the rights, responsibilities, and liabilities of parties to wholesale funds transfers.

Comment is requested by August 6, 1990.

The revision to Subpart B would:

- provide a more comprehensive set of rules for funds transfers involving Federal Reserve Banks than is currently provided by Subpart B;
- make Subpart B consistent with state laws applicable to funds transfers as states adopt Article 4A; and
- help to ensure that, subject to their central banking responsibilities, Federal Reserve Banks compete on an equitable basis with private-sector providers of funds-transfer services.

Because Article 4A is expected to become effective in a number of states by January 1, 1991, the Board anticipates that it will adopt a final revised Subpart B of Regulation J effective on that date.

Enclosed — for depository institutions — is the text of the Board's proposal, as submitted for publication in the *Federal Register*; an additional copy may be obtained from our Circulars Division (Tel. No. 212-720-5215 or 5216). Comments thereon must be submitted by August 6, 1990, and may be sent to the Board as indicated in the notice, or to our Funds Transfer Department.

Questions on this matter may be directed to Andrew Heikaus, Manager, Fund Transfer Department (Tel. No. 212-720-5561).

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 210

[Regulation J; Docket No. R-0697]

Funds Transfers Through Fedwire

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board has adopted a proposed comprehensive revision of Subpart B to Regulation J to make it consistent with the new Article 4A of the Uniform Commercial Code, Funds Transfers. The proposed revision sets out the rules governing funds transfers through Fedwire, as well as commentary to the proposed regulation that would constitute a Board interpretation of the regulation.

DATE: Comments must be submitted on or before August 6, 1990. No extension of time for comment will be provided.

ADDRESSES: Comments, which should refer to Docket No. R-0697, may be mailed to the Board of Governors of the Federal Reserve System, 20th and C Streets N.W., 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.

FOR FURTHER INFORMATION CONTACT: Oliver Ireland, Associate General Counsel (202/452-3625) or Colleen McCall, Staff Attorney, (202/452-6406), Legal Division; or Louise L. Roseman, Assistant Director, Division of Federal Reserve Bank Operations (202/452-3874); for the hearing impaired only: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

For many years, the Regulation J provisions on funds transfers handled by Federal Reserve Banks constituted the only codified body of law applicable to funds transfers. Although Subpart B of Regulation J specified the rules applicable to the funds transfers handled by Federal Reserve Banks, there were no codified rules, other than private agreements governing wholesale funds transfers handled by other banks, or by private funds-transfer systems.¹ Further, Regulation J did not provide

¹ In 1978, Congress adopted the Electronic Fund Transfer Act to establish consumer rights in funds transfers. 15 U.S.C. (continued...)

comprehensive rules for the relationship between banks and their customers that were parties to funds transfers handled by Federal Reserve Banks. Although there was no comprehensive body of statutory or regulatory law on wholesale funds transfers (and only limited case law has developed in this area), the number and dollar volume of funds transfers in the United States has grown to very high levels. More than 350,000 funds transfers, with a total value between \$1 trillion and \$2 trillion, are processed in the United States each day over the Fedwire and CHIPS systems.

To provide a legal framework for these transactions, several years ago the National Conference of Commissioners on Uniform State Laws, the sponsoring organization for the Uniform Commercial Code and other uniform state laws, undertook to develop a new Article 4A to the Uniform Commercial Code on funds transfers. This project was completed in 1989 with the assistance of representatives of the banking and the corporate user community, as well as the Federal Reserve System. Article 4A has already been adopted in several states, and has been introduced in the legislatures of a number of other states. The Board expects that Article 4A will become effective in many of these states by January 1991 and will be adopted in most, if not all, remaining states within the next few years.²

Article 4A provides comprehensive rules governing the rights and responsibilities of the parties to wholesale funds transfers.³ These rights and responsibilities include: responsibility for unauthorized, erroneous, or erroneously executed funds transfers, risks of loss associated with the failure of a bank handling a funds transfer, responsibilities to pay for and the right to receive payment for funds transfers, and

¹(...continued)

§ 1693 et seq. This Act does not apply, however, to wire transfers sent through Fedwire. 15 U.S.C. § 1693a(6)(B).

² Copies of Article 4A are available upon request from the Board's Public Affairs Office.

³ Transactions covered by Article 4A include wire transfers sent over Fedwire or CHIPS, book transfers, and automated clearing house ("ACH") credit transfers, other than ACH transfers subject to the Electronic Fund Transfer Act. Currently, that Act does not cover preauthorized ACH transfers received by a financial institution with assets of \$25 million or less, if the institution does not provide any other electronic payment services to its consumer customers (see 12 CFR 205.3(g)). Consequently, these transfers would be subject to Article 4A. Subpart B does not apply to any ACH transfers.

the effect of payment by funds transfer on any contractual obligation between an originator and a beneficiary underlying a funds transfer.

Although many of the concepts embodied in the current version of Subpart B of Regulation J are similar to those embodied in Article 4A, a number of the Subpart B provisions are inconsistent with the structure of Article 4A, and the terminology of Subpart B and Article 4A differ substantially.

The Board is proposing to revise Subpart B of Regulation J so as to apply Article 4A to funds transfers handled by Federal Reserve Banks, subject to a limited number of modifications and clarifications that are consistent with the purposes of Article 4A and that generally could be made by a private funds-transfer system by means of a funds-transfer system rule under Article 4A.⁴ This revision to Subpart B would: (1) provide a more comprehensive set of rules for funds transfers involving Federal Reserve Banks than is currently provided by Subpart B; (2) make Subpart B consistent with state laws applicable to funds transfers as states adopt Article 4A; and (3) help to ensure that, subject to their central banking responsibilities, Federal Reserve Banks compete on an equitable basis with private-sector providers of funds-transfer services. Because it expects Article 4A to become effective in a number of states by January 1991, the Board anticipates that it will adopt a final revised Subpart B of Regulation J, effective January 1, 1991.

Scope. The proposed revision to Subpart B would incorporate those provisions of Article 4A into Subpart B that are not inconsistent with the provisions set forth expressly in Subpart B. Thus, Article 4A would apply to transactions involving Federal Reserve Banks even if the state in which the Federal Reserve Bank is located had not yet adopted Article 4A. The Board believes that this incorporation is necessary to ensure that the law applicable to funds transfers involving Federal Reserve Banks is uniform for all Fedwire funds transfers, regardless of the location of the banks involved in the funds transfer. Consistent with the provisions of Article 4A

⁴ Under Section 4A-107, Federal Reserve regulations and operating circulars supersede inconsistent provisions of Article 4A. In addition, under the Expedited Funds Availability Act, the Board has broad authority to issue regulations concerning the payments system. In proposing the revised Subpart B, the Board has not relied extensively on these unique powers and has attempted to treat Federal Reserve Banks like private-sector banks.

concerning the choice of law by rules of private funds-transfer systems, Subpart B would apply to all banks sending payment orders to or receiving payment orders from Federal Reserve Banks as well as to any remote parties to the funds transfers. This "end-to-end" coverage of funds transfers through Federal Reserve Banks ensures that the scheme of rights and liabilities under Article 4A operates effectively. For example, under Article 4A, an originator⁵ of a funds transfer is discharged from any underlying payment obligation to a beneficiary of a funds transfer when the beneficiary's bank accepts the funds transfer (see Section 4A-406(a)). If the beneficiary's bank does not accept the funds transfer, the originator has a "money-back guarantee" and does not have to pay for the funds transfer unless the failure to complete the funds transfer is due to the failure of an intermediary bank designated by the originator (see Section 4A-402). Thus, it is necessary to apply Subpart B to originators and beneficiaries of funds transfers involving Federal Reserve Banks so that the provisions applicable to the banks handling such funds transfers will function with the provisions applicable to their customers.⁶

Although applying Subpart B to the customer-bank relationship of banks sending or receiving funds transfers through Federal Reserve Banks provides a consistent body of law applicable to these funds transfers, it will also place responsibilities on these banks that are not expressly provided for under Subpart B or other current law. For example,

⁵ Under Article 4A, an "originator" of a funds transfer is the first party, often a bank customer, to initiate the series of payment orders that comprise a funds transfer. The "beneficiary" is the person to be paid under the funds transfer.

⁶ These provisions would not apply to those originators and beneficiaries that are not aware that the funds transfer may be sent through Fedwire. This limitation ensures that customers are aware of the rules that apply to their transactions. To encourage banks to notify their customers that Fedwire may be used for their funds transfers, the proposed Subpart B includes a warranty by the bank sending or receiving a funds transfer through Fedwire that all remote parties to the transfer have been provided such a notice. Provision of this notice to originators and beneficiaries of funds transfers through Fedwire also extends the Article 4A limitation on consequential damages to claims against Federal Reserve Banks by originators and beneficiaries of transfers through Fedwire. The Board expects that private funds-transfer systems will require similar warranties or employ other similar means to ensure that originators and beneficiaries are notified of the use of their funds-transfer system.

Article 4A requires all banks to adopt commercially reasonable security procedures or assume liability for unauthorized funds transfers (see Sections 4A-202 and 4A-203). Similarly, a beneficiary's bank that accepts a funds transfer handled by a Federal Reserve Bank generally must notify the beneficiary of receipt of the payment order by midnight of the next funds-transfer business day after receipt of the funds transfer and the beneficiary's bank must pay the beneficiary on the day the transfer is made (see Section 4A-404). While these, and possibly other, requirements of Article 4A may require operating changes at banks using Fedwire, the Board expects that these changes ultimately will be required by state law and that they are desirable at this time in order to ensure a comprehensive legal framework for Fedwire funds transfers.

Liability. Under the current Subpart B, Federal Reserve Banks are liable to banks sending funds transfers directly to them for mishandling funds transfers. This liability does not extend to beneficiaries or originators of funds transfers, other than those sending funds transfers directly to Federal Reserve Banks, and excludes liability for consequential damages, such as the opportunity cost of a transaction that was not completed because of a problem with a Fedwire funds transfer. Under Article 4A, a bank handling a funds transfer, such as a Federal Reserve Bank, may be liable (1) to a bank sending a payment order to it for principal and interest for executing an unauthorized payment order (see Section 4A-204), or (2) to the originator or beneficiary of a funds transfer for interest for a delay in executing a funds transfer or delay in notifying the beneficiary of receipt of a funds transfer (see Sections 4A-302 and 4A-305). The parties to whom a Federal Reserve Bank may be liable under Article 4A are broader than the parties to whom a Federal Reserve Bank may be liable under the current Subpart B. Therefore, Federal Reserve Banks may incur liability under Article 4A in situations where they would not incur liability under current Subpart B. Nevertheless, the Board believes that it is appropriate to apply the Article 4A liability provisions to Federal Reserve Banks both because the liability scheme adopted by Article 4A is integral to its operative rules, and because it results in the Federal Reserve Banks assuming liabilities comparable to those assumed by private-sector banks.

Although the revised Subpart B would result in a change in the Federal Reserve Banks' liability in connection with the handling of funds transfers, it would continue the current procedure established under Subpart B of using "as of adjustments" to compensate banks dealing with a Federal Reserve Bank for lost interest due to Federal Reserve Bank errors in handling a funds transfer or to recover float. An as of adjustment is a memorandum credit or debit that is applied to a

reserve or clearing balance position of a bank. These adjustments affect the level of reserve or clearing balances that the bank must fund by other means and are therefore an effective substitute for explicit interest payments. Under the proposed revision to Subpart B, banks would be required to pass as of adjustments on to their customers by explicit interest payments or other means agreed to by the bank's customer. Where compensation for interest by means of an as of adjustment would not be useful to the bank entitled to it -- e.g., if it meets its reserve requirements through vault cash and had no reserve or clearing balance requirement -- the Federal Reserve Bank would pay explicit interest to discharge any obligation to pay interest under Article 4A.

Miscellaneous. In addition to the issues of scope and liability discussed above, the proposed revision to Subpart B defines terms not defined in Article 4A; notifies users of Fedwire that Reserve Banks will exercise their right under Article 4A to rely on account numbers; specifies sending banks' duties to pay for funds transfers sent over Fedwire and to secure overdrafts; grants Federal Reserve Banks a security interest in certain collateral; requires off-line receiving banks to notify their Federal Reserve Bank if they maintain accounts for respondent banks, so that the Federal Reserve Bank will execute all payment orders, including settlement transfers, on a timely basis;⁷ specifies the means of payment by Federal Reserve Banks to banks receiving payment orders over Fedwire; and addresses the timing and routing of Fedwire funds transfers. The details of these provisions are set forth more fully in the proposed regulation and commentary.

Competitive Impact Analysis.

The Board recently formalized its procedures for assessing the competitive impact of changes that have a substantial effect on payments-system participants.⁸ Under these procedures, the Board will assess whether the proposed change would have a direct and material adverse effect on the

⁷ This warranty is consistent with a recent Board proposal that the Federal Reserve Banks notify by telephone all off-line depository institutions of the receipt of incoming Fedwire third-party funds transfers and incoming Fedwire settlement transfers if the receiving bank maintains accounts for respondent institutions (see 55 FR 18758, April 30, 1990).

⁸These procedures are described in the Board's policy statement titled "The Federal Reserve in the Payments System," which was revised in March 1990.

ability of other service providers to compete effectively with the Federal Reserve in providing similar services due to differing legal powers or constraints or due to a dominant market position of the Federal Reserve deriving from such legal differences. The following is a section-by-section competitive impact analysis of the proposed revision to Subpart B of Regulation J.

210.25 -- Authority, purpose, and scope. Article 4A provides that most, but not all, of its provisions may be varied by agreement of the affected parties, or by a funds-transfer system rule (see Section 4A-501). A funds-transfer system rule may select the law of a particular state to govern the rights and obligations of the participants in the funds-transfer system, and to govern the rights and obligations of remote parties in the transfer to the extent they were given notice that funds-transfer system may be used, and of the choice of law of that system (see Section 4A-507). The Federal Reserve can supersede any portion of Article 4A by Board regulation or Federal Reserve Bank Operating Circular (see Section 4A-107). In addition, the Board can preempt Article 4A provisions under its authority pursuant to the Expedited Funds Availability Act (12 U.S.C. 4001 et seq.) to regulate any aspect of the payments system in order to expedite availability of funds or otherwise carry out the provisions of that Act.

The Board does not believe that the proposed Subpart B supersedes or preempts any express provisions of Article 4A. The proposed Subpart B generally varies Article 4A provisions only to the extent that such provisions could be varied by agreement or by a private-sector funds-transfer system rule. In addition, the scope of applicability of Subpart B is equal to that of a funds-transfer system rule that adopts a choice of law provision. Specifically, proposed Subpart B governs only parties in privity with Federal Reserve or remote parties that received notice that Fedwire may be used to make the funds transfer and of the law governing Fedwire transfers.

Under Sections 210.28(c) and 210.29(c) of the proposed regulation, parties in privity with the Federal Reserve warrant that remote parties to the funds transfer have been given notice that Fedwire may be used to make the funds transfer and that Subpart B governs Fedwire funds transfers. These warranties are consistent with the Article 4A provision that funds-transfer system rules may bind remote parties to the transfer to the extent that the remote parties received notice (see Section 4A-507(c)). A funds-transfer system rule may require participants in the system to provide this notice to remote parties, or require that participants warrant to each other that such notices have been provided, thereby giving the participants the option of

providing the notice or assuming legal responsibility for failure to provide the notice (see also analyses to Sections 210.28 and 210.29). Similarly, banks may require their customers to either notify remote parties or warrant that such notice has been given.

In the case of a funds transfer involving both Fedwire and another funds-transfer system, such as CHIPS, Subpart B will preempt any inconsistent funds-transfer system rule or agreement applicable to a remote party that received notice that Fedwire may be used to make the transfer and of the governing law. The prefatory note to Article 4A explains that Article 4A provides a needed comprehensive body of law governing wholesale wire transfers, and thus removes the great deal of uncertainty that currently exists, particularly with respect to parties to a transfer that are not direct participants in the funds-transfer system that is used. The Board believes that conflicts between funds-transfer system rules under Article 4A may arise. Having Subpart B take precedence over private funds-transfer system rules is consistent with the objective of Article 4A to provide certainty of law in the case of conflicting provisions of Subpart B and the rules of a funds-transfer system that is also used in the transfer. Because Subpart B parallels closely the Article 4A provisions, the Board does not believe that there will be many instances where private-sector funds-transfer system rules would be inconsistent with, and thus preempted by, the provisions of Subpart B.

The Board does not believe that the scope of proposed Subpart B, or the approach taken in incorporating the Article 4A provisions in this Subpart, would have an adverse competitive effect.

210.26 -- Definitions. Proposed Subpart B generally incorporates the definitions set forth in Article 4A, and includes definitions of other terms not defined in Article 4A. The proposed Subpart modifies the definitions of two Article 4A terms -- "beneficiary's bank" and "payment order."

The Subpart B definition of "beneficiary's bank" clarifies that a Federal Reserve Bank may be a beneficiary's bank even though it is not explicitly identified as such in the payment order. This appears to be consistent with the intent of Article 4A, although the Article 4A definition does not contemplate a bank acting as a beneficiary's bank without being designated as such in the payment order.

Proposed Subpart B also provides that a Federal Reserve Bank that is the beneficiary of a payment order is also deemed to be the beneficiary's bank on the payment order. Under Article 4A, the bank that sends the payment order to the Federal Reserve

Bank as beneficiary would be considered the beneficiary's bank. In the context of Fedwire payment orders, deeming a Federal Reserve Bank to be the beneficiary's bank as well as the beneficiary of a payment order does not have any practical operational or legal impact on the other parties to the funds transfer. The Board does not believe that these changes would have an adverse competitive effect.

The Subpart B definition of payment order excludes ACH transfers, which are subject to a separate Federal Reserve Bank Operating Circular, and excludes certain messages, such as service messages, which are not intended to be payment orders under Article 4A. The Board does not believe that this definition would have any adverse competitive effect.

210.27 -- Reliance on identifying number. Article 4A provides that a bank may rely on the number in the payment order identifying an intermediary bank, the beneficiary's bank, or the beneficiary, even if the number is inconsistent with the name, if the bank does not know that the name and number refer to different persons (see Sections 4A-207 and 4A-208). The originator is obligated to pay the payment order (in the case of reliance on the number of beneficiary) and the sender is obligated to compensate the receiving bank for any loss or expenses incurred (in the case of reliance on the number of the intermediary bank or beneficiary's bank) if the number was relied upon and the originator or sender is a bank or if the originator or sender is a nonbank that had notice of the possible reliance on the number.

Proposed Subpart B includes provisions providing notice to nonbank senders that Federal Reserve Banks may rely on the numbers in the payment orders identifying the intermediary bank, the beneficiary's bank, and the beneficiary. Federal Reserve Banks will provide the Subpart B rules to their nonbank senders, in part, to ensure that these provisions serve as actual notice to these senders. Therefore, this notice would be provided by means similar to those that the Board presumes banks will use to give this notice to their nonbank senders, and would not have any adverse competitive effect.

210.28 -- Agreement of sender. This section provides that a sender authorizes its Federal Reserve Bank to obtain payment for a payment order by debiting the sender's account at the Federal Reserve Bank. In addition, this section provides that a sender does not have a right to an overdraft in its account, when overdrafts that are incurred become due and payable, and what actions a Federal Reserve Bank may take to recover the amount of an overdraft or to secure an overdraft. The Board does not believe that these provisions would have an

adverse competitive effect because: (1) a sender does not have a right to overdraft its Federal Reserve account, (2) the requirements are reasonable, and are not obtainable solely due to unique bargaining position of the Federal Reserve, and (3) a private-sector bank could impose similar requirements on its customers to which it gives overdraft privileges.

This section also provides that a sender of a payment order to a Federal Reserve Bank warrants that all prior senders have been notified of the possible use of Fedwire to effect the transfer, and of the rules governing Fedwire. This warranty is important to achieve "end-to-end" coverage of a funds transfer under the Article 4A provisions, as incorporated in Subpart B, and also to protect the Federal Reserve Banks from potential liability for consequential damages to parties in states that have not adopted the Article 4A limitation on consequential damages (see Section 4A-305). The Board anticipates that other funds-transfer systems and banks providing funds-transfer services will either require that their senders provide such a notice, or require that their senders warrant that such notice has been given (see also the analysis of Section 210.25). Consequently, the Board does not believe that this provision will have an adverse competitive effect.

Finally, Article 4A provides that the sender must notify a receiving bank of an unauthorized, erroneous, or erroneously executed payment order within a reasonable time not exceeding 90 days from receipt of the notice of the order (see Section 4A-304). Regulation J currently provides that a sender is deemed to approve the accuracy of an advice of debit unless it objects in writing within 10 calendar days of receipt of the advice (see current Section 210.34(b)). Proposed Section 210.28(d) specifies 10 funds-transfer business days as the reasonable time within which senders must act, for the purposes of receiving interest or compensation for losses as provided in Article 4A. Similarly, under Article 4A, banks may establish by agreement what constitutes a reasonable time to provide this notice (see Section 4A-501); therefore, the Board does not believe that this requirement results in any adverse competitive effect.

210.29 -- Agreement of receiving bank. This section requires an off-line bank to notify its Federal Reserve Bank if it maintains an account for another bank, so that the Federal Reserve Bank will provide telephone notice for all Fedwire funds transfers received by that bank, including settlement transfers. If the off-line bank does not provide this notice to its Federal Reserve Bank, it warrants that it does not act as the beneficiary's bank with respect to Fedwire payment orders for a beneficiary that is a bank.

The Board believes that this warranty would have no adverse competitive effect. For example, the Board believes that this action would have no adverse competitive effect on the operations of CHIPS, because this system does not serve low-volume institutions and all CHIPS participants are on-line to that system. Further, this warranty is a reasonable provision designed to enable Federal Reserve Banks to fulfill their obligation under Section 4A-302 to execute payment orders at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible. The ability to require this warranty is not derived from unique bargaining position on the part of the Federal Reserve Banks; correspondent banks that provide funds-transfer services to off-line respondent banks could impose a similar warranty on their respondent receivers.

Under Section 210.29, a receiving bank also warrants that all subsequent parties to the funds transfer were notified that Fedwire might have been used to make the transfer and of the law governing Fedwire. See the analysis of the warranty of the sender of a Fedwire payment order, discussed with respect to Section 210.28.

210.30 -- Payment orders. This section sets forth the terms under which a Federal Reserve Bank will accept payment orders from the sender. The section provides: that a sender must have authorization to send Fedwire payment orders to a Federal Reserve Bank; that a Federal Reserve Bank may reject any payment order; that a Federal Reserve Bank may execute a payment order through another Federal Reserve Bank; that a sender may not instruct a Federal Reserve Bank to select an intermediary bank other than a Federal Reserve Bank unless that bank is designated in the sender's payment order; and that a sender generally may not send a value-dated payment order through Fedwire. The Board believes that these provisions are reasonable and that private-sector receiving banks may arrange similar terms with their senders; therefore, these provisions do not rely on unique bargaining power of Federal Reserve Banks. Consequently, the Board believes that these provisions do not have an adverse competitive effect.

210.31 -- Payment by a Federal Reserve Bank to a receiving bank or beneficiary. The primary distinguishing characteristic of Fedwire is that payment orders are final and irrevocable to the receiver when made. This section, regarding when a Federal Reserve Bank makes payment to a receiving bank or beneficiary, parallels current Section 210.36(a) by providing that payments to receiving banks and beneficiaries are final at the earlier of the time when the amount of the payment order is

credited to the receiving bank's or beneficiary's account, or when the payment order is sent to the receiving bank or when notice of the credit is sent to the beneficiary. Fedwire's payment finality could be viewed as a sufficiently significant benefit to participants as to have an adverse effect on competing private-sector funds-transfer systems. However, the Board believes that Fedwire payment finality is vital to the continued integrity and efficiency of the payments system. Moreover, CHIPS will soon be instituting a loss-sharing arrangement to ensure the finality of its settlement, thus increasing the certainty of final payment over that system. Correspondent banks providing funds-transfer services can provide payments finality similar to that specified in proposed Section 210.32 to their respondent banks and beneficiaries (see Section 4A-405). For these reasons the Board believes that the benefits of Fedwire payment finality -- the certainty of payment and the elimination of systemic risk -- outweigh any possible adverse competitive effect.

210.32 -- Federal Reserve Bank liability; payment of interest. Article 4A provides that a bank is not liable for consequential damages, unless it agrees to be subject to such damages by express written agreement. This section makes clear that Federal Reserve Banks do not agree to be subject to consequential damages, and is consistent with the presumption in Article 4A. The Board believes that many private-sector providers of funds-transfer services will also not agree to be subject to consequential damages; consequently, the Board believes that this provision does not have an adverse competitive effect.

Article 4A provides that the amount of interest payable under its provisions may be determined by agreement or funds-transfer system rule. Subpart B provides that a Federal Reserve Bank may provide interest compensation through either an as of adjustment or explicit interest payment. The Board believes that providing interest compensation in the form of as of adjustments would not have an adverse competitive effect because the Federal Reserve includes the imputed cost of as of adjustments related to Fedwire transfers (computed at the federal funds rate) in its total cost of providing the Fedwire funds-transfer service. Moreover, the Board believes that banks could agree with their customers under Article 4A to similar arrangements using compensating balances, which would be analogous to an as of adjustment provided by a Federal Reserve Bank. In cases where a Federal Reserve Bank provides compensation in the form of explicit interest, interest would be calculated in accordance with the procedures specified in Article 4A (see Section 4A-506(b)).

Initial Regulatory Flexibility Analysis.

The Regulatory Flexibility Act (5 U.S.C. 601-612) requires an agency to publish an initial regulatory flexibility analysis with any notice of proposed rulemaking. An initial regulatory flexibility analysis must describe the reasons why action by the agency is being considered and state the objectives of, and the legal basis for the proposed rule (5 U.S.C. 603(b)(1) and (2)). This information is contained elsewhere in this notice of proposed rulemaking. The proposed rules require no additional reporting or recordkeeping nor are there relevant federal rules that duplicate, overlap, or conflict with the proposed rule.

The initial regulatory flexibility analysis must also describe and, where feasible, estimate the number of small entities to which the proposed rule will apply. Subpart B of Regulation J will be applicable to all direct Fedwire participants and all parties receiving notice that Fedwire may be used to complete at least part of the funds transfer and that Subpart B is the governing law for Fedwire. Thus, Subpart B potentially affects all depository institutions, and any business or individual that may send or receive a funds transfer through Fedwire.

The Board does not believe that there are any significant alternatives to the proposed revision of Subpart B of Regulation J that would (1) provide comprehensive rules for funds transfers involving Federal Reserve Banks, (2) make Subpart B consistent with state laws applicable to funds transfers as more states adopt Article 4A, and (3) help ensure that, subject to their central banking responsibilities, Federal Reserve Banks compete on an equitable basis with private-sector providers of funds-transfer services and concurrently minimize any significant economic impact of the proposed rule on small entities.

The Board has not proposed an exemption from coverage for small entities that send or receive payment orders through Fedwire. The purpose of the proposed rule is to provide comprehensive rules for funds transfers that go through Fedwire. This purpose would not be achieved if the rules did not apply to small entities that send or receive funds transfers through Fedwire. Moreover, Subpart B could not provide end-to-end coverage for a funds transfer if small institutions were excepted from its coverage. For example, end-to-end coverage permits the originator and the beneficiary of the funds transfer to determine when the originator's obligation to the beneficiary is discharged. Further, the rules confer important rights upon parties to a Fedwire funds transfer, such as the right to receive interest in certain circumstances, and provide a shield from liability for consequential damages if a mishap occurs. These

rights would benefit small institutions as well as larger institutions. The Board does not believe that complying with the proposed Subpart B rules will impose a significant cost on depository institutions, including small institutions.

List of Subjects in 12 CFR Part 210

Banks, banking; Federal Reserve System.

For the reasons set out in the preamble, the Board proposes to amend 12 CFR Part 210 as follows:

PART 210 -- Regulation J (COLLECTION OF CHECKS AND OTHER ITEMS BY FEDERAL RESERVE BANKS AND FUNDS TRANSFERS THROUGH FEDWIRE)

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

AUTHORITY: Federal Reserve Act, sec. 13 (12 U.S.C. 342), sec. 11(i) and (j) (12 U.S.C. 248(i) and (j)), sec. 16 (12 U.S.C. 248(o) and 360), and sec. 19(f) (12 U.S.C. 464); and the Expedited Funds Availability Act (12 U.S.C. 4001 et seq.)

2. Subpart B, consisting of sections 210.25 through 210.32, and Appendix A, is revised to read as follows:

Subpart B -- Funds Transfers Through Fedwire

210.25 Authority, purpose, and scope.

210.26 Definitions.

210.27 Reliance on identifying number.

210.28 Agreement of sender.

210.29 Agreement of receiving bank.

210.30 Payment orders.

210.31 Payment by a Federal Reserve Bank to a receiving bank or beneficiary.

210.32 Federal Reserve Bank liability; payment of interest.

Appendix A to Subpart B -- Commentary.

Subpart B -- Funds Transfers through Fedwire

§ 210.25 Authority, purpose, and scope.

(a) Authority and purpose.

This Subpart provides rules to govern funds transfers through Fedwire, and has been issued pursuant to the Federal Reserve Act -- section 13 (12 U.S.C. 342), paragraph (f) of section 19 (12 U.S.C. 464), paragraph 14 of section 16 (12 U.S.C. 248(o)), and paragraphs (i) and (j) of section 11 (12 U.S.C. 248(i) and (j)) -- and other laws and has the force and effect of federal law. This Subpart is not a funds-transfer system rule as defined in Section 4A-501(b) of the Uniform Commercial Code.

(b) Scope.

(1) This Subpart incorporates the provisions of Article 4A unless they are inconsistent with the express provisions of this Subpart.

(2) This Subpart governs the rights and obligations of:

(i) Federal Reserve Banks sending or receiving payment orders;

(ii) senders that send payment orders directly to a Federal Reserve Bank;

(iii) receiving banks that receive payment orders directly from a Federal Reserve Bank;

(iv) beneficiaries that receive payment for a payment order sent to a Federal Reserve Bank by means of a credit to an account maintained or used at a Federal Reserve Bank; and

(v) other parties to a funds transfer any part of which is carried out through Fedwire to the same extent as if this Subpart were considered a funds-transfer system rule under Article 4A.

(c) Operating Circulars.

Each Federal Reserve Bank shall issue an Operating Circular consistent with this Subpart that governs the details of its funds-transfer operations and other matters it deems appropriate. Among other things, the Operating Circular may:

set cut-off hours and funds-transfer business days; address available security procedures; specify format and media requirements for payment orders; identify messages that are not payment orders; and impose charges for funds-transfer services.

(d) Government senders, receiving banks, and beneficiaries.

Except as otherwise expressly provided by the statutes of the United States, senders, receiving banks, and beneficiaries that maintain or use an account with a Federal Reserve Bank include:

(1) a department, agency, instrumentality, independent establishment, or office of the United States, or a wholly-owned or controlled Government corporation;

(2) an international organization;

(3) a foreign central bank; and

(4) a department, agency, instrumentality, independent establishment, or office of a foreign government, or a wholly-owned or controlled corporation of a foreign government.

§ 210.26 Definitions.

As used in this Subpart, the following definitions apply:

(a) "Article 4A" means Article 4A of the Uniform Commercial Code.

(b) "As of adjustment" means a debit or credit, for reserve or clearing balance maintenance purposes only, applied to the reserve or clearing balance of a bank that either sends a payment order to a Federal Reserve Bank, or that receives a payment order from a Federal Reserve Bank, in lieu of an interest charge or payment.

(c) "Automated clearing house transfer" means any transfer designated as an automated clearing house transfer in a Federal Reserve Bank Operating Circular or in the rules of an automated clearing house association.

(d) "Beneficiary's bank" has the same meaning as in Article 4A, except that:

(1) a Federal Reserve Bank need not be identified in the payment order in order to be the beneficiary's bank; and

(2) the term includes a Federal Reserve Bank when that Federal Reserve Bank is the beneficiary of a payment order.

(e) "Fedwire" is the funds-transfer system owned and operated by the Federal Reserve Banks that is used primarily for the transmission and settlement of payment orders governed by this Subpart. Fedwire does not include the system for making automated clearing house transfers.

(f) "Interdistrict transfer" means a funds transfer involving entries to accounts maintained at two Federal Reserve Banks.

(g) "Intradistrict transfer" means a funds transfer involving entries to accounts maintained at one Federal Reserve Bank.

(h) "Off-line bank" means a bank that transmits payment orders to and receives payment orders from a Federal Reserve Bank by telephone or other means other than electronic data transmission.

(i) "Payment order" has the same meaning as in Article 4A, except that the term does not include automated clearing house transfers or any communication designated in a Federal Reserve Bank Operating Circular issued under this Subpart as not being a payment order.

(j) "Sender's account," "receiving bank's account," and "beneficiary's account" mean the reserve, clearing, or other funds deposit account at a Federal Reserve Bank maintained or used by the sender, receiving bank, or beneficiary, respectively.

(k) "Sender's Federal Reserve Bank" and "receiving bank's Federal Reserve Bank" mean the Federal Reserve Bank at which the sender or receiving bank, respectively, maintains or uses an account.

(l) "Uniform Commercial Code" or "UCC" means the Uniform Commercial Code as approved by the National Conference of Commissioners on Uniform State Laws and the American Law Institute from time to time.

§ 210.27 Reliance on identifying number.

(a) Reliance by a Federal Reserve Bank on number to identify an intermediary bank or beneficiary's bank.

A Federal Reserve Bank may rely on the number in a payment order that identifies the intermediary bank or beneficiary's bank, even if it identifies a bank different from the bank identified by name in the payment order, if the Federal Reserve Bank does not know of such an inconsistency in identification. A Federal Reserve Bank has no duty to detect any such inconsistency in identification.

(b) Reliance by a Federal Reserve Bank on number to identify beneficiary.

A Federal Reserve Bank, acting as a beneficiary's bank, may rely on the number in a payment order that identifies the beneficiary, even if it identifies a person different from the person identified by name in the payment order, if the Federal Reserve Bank does not know of such an inconsistency in identification. A Federal Reserve Bank has no duty to detect any such inconsistency in identification.

§ 210.28 Agreement of sender.

(a) Payment of sender's obligation to a Federal Reserve Bank.

A sender (other than a Federal Reserve Bank), by maintaining or using an account with a Federal Reserve Bank, authorizes the sender's Federal Reserve Bank to obtain payment for the sender's payment orders by debiting the amount of the payment order from the sender's account.

(b) Overdrafts.

(1) A sender does not have the right to an overdraft in its account. In the event an overdraft is created, the overdraft shall be due and payable immediately without the need for a demand by the Federal Reserve Bank, at the earliest of the following times:

(i) at the end of the funds-transfer business day;

(ii) at the time the Federal Reserve Bank, in its sole discretion, deems itself insecure and gives notice thereof to the sender; or

(iii) at the time the sender suspends payments or is closed.

(2) The sender shall have in its account, at the time the overdraft is due and payable, a balance of actually and finally collected funds sufficient to cover the aggregate amount of all its obligations to the Federal Reserve Bank, whether the obligations result from the execution of a payment order or otherwise.

(3) A Federal Reserve Bank may take any action authorized by law to recover the amount of an overdraft that is due and payable, including, but not limited to, the exercise of rights of set off, the realization on any available collateral, and any other rights it may have as a creditor under applicable law.

(4) To secure any overdraft, as well as any other obligation due or to become due to its Federal Reserve Bank, each sender, by sending a payment order to a Federal Reserve Bank that is accepted by the Federal Reserve Bank, grants to the Federal Reserve Bank a security interest in all of the sender's assets in the possession of, or held for the account of, the Federal Reserve Bank. The security interest attaches when an overdraft becomes due and payable.

(c) Notice by sender of use of Fedwire.

A sender sending a payment order directly to a Federal Reserve Bank warrants to the Federal Reserve Bank that all prior senders of payment orders comprising that funds transfer have been notified that Fedwire might be used in that funds transfer and that the rights and obligations of the parties to the funds transfer are governed by Subpart B.

(d) Review of payment orders.

A sender, by sending a payment order to a Federal Reserve Bank, agrees that for the purposes of Sections 4A-204(a), 4A-205(b), and 4A-304 of the Uniform Commercial Code, a reasonable time to notify a Federal Reserve Bank of the relevant facts concerning an unauthorized, erroneous, or erroneously executed payment order is within ten funds-transfer business days after the sender receives notice that the payment order was accepted or executed, or that the sender's account was debited with respect to the payment order.

§ 210.29 Agreement of receiving bank.

(a) Payment.

A receiving bank (other than a Federal Reserve Bank) that receives a payment order from its Federal Reserve Bank authorizes that Federal Reserve Bank to pay for the payment order by crediting the amount of the payment order to the receiving bank's account.

(b) Off-line banks.

An off-line bank that does not expressly notify its Federal Reserve Bank in writing that it maintains an account for another bank warrants to that Federal Reserve Bank that the off-line bank does not act as a beneficiary's bank with respect to payment orders received through Fedwire for a beneficiary that is a bank.

(c) Notice by receiving bank of use of Fedwire.

A receiving bank receiving a payment order directly from a Federal Reserve Bank warrants to the Federal Reserve Bank that all subsequent receiving banks of payment orders comprising that funds transfer and the beneficiary of the funds transfer have been notified that Fedwire might be used in the funds transfer and that the rights and obligations of the parties to the funds transfer are governed by Subpart B.

§ 210.30 Payment orders.

(a) Rejection.

A sender shall not send a payment order to a Federal Reserve Bank unless authorized to do so by the Federal Reserve Bank. A Federal Reserve Bank may reject, or impose conditions that must be satisfied before it will accept, a payment order for any reason.

(b) Selection of an intermediary bank.

For an interdistrict transfer, a Federal Reserve Bank is authorized and directed to execute a payment order through another Federal Reserve Bank. A sender shall not send a payment order to a Federal Reserve Bank that requires the Federal Reserve Bank to issue a payment order to an intermediary bank (other than a Federal Reserve Bank) unless that intermediary bank is designated in the sender's payment order. A sender shall not send to a Federal Reserve Bank a payment order instructing use by a Federal Reserve Bank of a funds-transfer system or means of

transmission other than Fedwire, unless the Federal Reserve Bank agrees with the sender in writing to follow such instructions.

(c) Same-day execution.

A sender shall not issue a payment order that instructs a Federal Reserve Bank to execute the payment order on a funds-transfer business day that is later than the funds-transfer business day on which the order is received by the Federal Reserve Bank, unless the Federal Reserve Bank agrees with the sender in writing to follow such instructions.

§ 210.31 Payment by a Federal Reserve Bank to a receiving bank or beneficiary.

(a) Payment to a receiving bank.

Payment of a Federal Reserve Bank's obligation to pay a receiving bank (other than a Federal Reserve Bank) occurs at the earlier of the time when the amount of the payment order is credited to the receiving bank's account or when the payment order is sent to the receiving bank.

(b) Payment to a beneficiary.

Payment by a Federal Reserve Bank to a beneficiary of a payment order, where the Federal Reserve Bank is the beneficiary's bank, occurs at the earlier of the time when the amount of the payment order is credited to the beneficiary's account or when notice of the credit is sent to the beneficiary.

§ 210.32 Federal Reserve Bank liability; payment of interest.

(a) Damages.

A Federal Reserve Bank shall not agree with a sender, receiving bank, or other Federal Reserve Bank to be held liable for consequential damages or any damages other than those payable under Article 4A.

(b) Payment of interest.

(1) A Federal Reserve Bank, in its discretion, may provide an as of adjustment to its sender, its receiving bank or its beneficiary as a means of paying compensation in the form of interest, as provided in the Federal Reserve Bank's Operating Circular. The amount of the as of adjustment shall equal the amount of the error multiplied by the number of days that the error remained uncorrected.

(2) If the sender or receiving bank that is the recipient of an as of adjustment in the form of a credit is not the party entitled to payment under Article 4A, the sender or receiving bank shall pass through the benefit of the as of adjustment by making a payment of interest, as of the day the as of adjustment is effected, to the appropriate originator or beneficiary. The interest shall be calculated in accordance with Section 4A-506(b) of the Uniform Commercial Code. The originator or beneficiary may agree to accept compensation in a form other than a direct payment of interest, provided that such an alternative form of interest is not less than the value of the interest payment that otherwise would be made.

(3) The Federal Reserve Bank shall pay interest, in accordance with Section 4A-506 of the Uniform Commercial Code, to parties entitled to such interest, if the sender, receiving bank, or beneficiary would be unable to make use of an as of adjustment because of a low or zero reserve and/or clearing balance requirement.

(c) Nonwaiver of right of recovery.

Nothing in this Subpart or any Operating Circular issued hereunder shall constitute, or be construed as constituting, a waiver by a Federal Reserve Bank of a cause of action for recovery under any applicable law of mistake and restitution.

Appendix A to Subpart B -- Commentary

The Commentary provides background material to explain the intent of the Board of Governors of the Federal Reserve System ("Board") in adopting a particular provision in the Subpart and to help readers interpret that provision. In some comments, examples are offered. The Commentary constitutes an official Board interpretation of Subpart B. Commentary is not provided for every provision of Subpart B, as some provisions are self-explanatory.

Section 210.25 -- Authority, purpose, and scope.

(a) Authority and purpose.

Section 210.25(a) states that the purpose of Subpart B is to provide rules to govern funds transfers through Fedwire and recites the Board's rulemaking authority for this Subpart. Subpart B is federal law and is not a "funds-transfer system rule," as defined in Section 4A-501(b) of Article 4A, Funds Transfers, of the Uniform Commercial Code. Certain provisions of Article 4A may not be varied by a funds-transfer system rule, but

under Section 4A-107 regulations of the Board and Operating Circulars of the Federal Reserve Banks supersede inconsistent provisions of Article 4A to the extent of the inconsistency. In addition, regulations of the Board may preempt inconsistent provisions of state law. Accordingly, Subpart B of Regulation J supersedes or preempts inconsistent provisions of state laws.

(b) Scope.

(1) Subpart B incorporates consistent provisions of Article 4A of the Uniform Commercial Code. Thus, the provisions set forth expressly in Subpart B supersede or preempt any inconsistent provisions of Article 4A as enacted in any state. Subpart B applies to any party to a Fedwire funds transfer that is in privity with a Federal Reserve Bank. These parties include a sender (bank or nonbank) that sends a payment order directly to a Federal Reserve Bank, a receiving bank that receives a payment order directly from a Federal Reserve Bank, and a beneficiary that receives credit to an account that it uses or maintains at a Federal Reserve Bank for a payment order sent to a Federal Reserve Bank. Other parties to a funds transfer are covered by this Subpart to the same extent that this Subpart would apply to them if this Subpart were a "funds-transfer system rule" under Article 4A that selected Subpart B as the governing law.

(2) The scope of the applicability of a funds-transfer system rule under Article 4A is specified in Section 4A-501(b), and the scope of the choice of law provision is specified in Section 4A-507(c). Under Section 4A-507(c), a choice of law provision is binding on the participants in a funds-transfer system and certain other parties having notice that the funds-transfer system might be used for the funds transfer and of the choice of law provision. Consequently, if the notice requirements of Section 4A-507(c) are met, the rights and obligations of all parties to a funds transfer any part of which is carried out by means of Fedwire will be governed by Subpart B.

(3) The Board believes that it is desirable to have a coherent body of law apply to all parties to a funds transfer, including originators, other senders, receiving banks, and beneficiaries. In addition, the application of Subpart B to parties not in privity with a Federal Reserve Bank may affect a Federal Reserve Bank's potential liability for consequential damages to parties in states that have not adopted the Section 4A-305 limitation on consequential damages (see Section 4A-305, which provides that consequential damages are only recoverable pursuant to an express agreement). Sections 210.28(c) and 210.29(c) encourage banks sending or receiving funds transfers over Fedwire to ensure that all parties to the funds transfer are notified of the potential use of

Fedwire by requiring senders and receiving banks to warrant to the Federal Reserve Bank that the notices contemplated by Section 4A-507(c) have been provided. Under this warranty the notices need not actually be provided; however, if they are not, the warrantor would be liable for losses incurred by a Federal Reserve Bank that would have been avoided if the notice was provided.

(4) If the notices to senders, receiving banks, and beneficiaries contemplated by Section 4A-507(c) are provided, Subpart B may apply to payment orders between banks or other parties remote from the Federal Reserve Bank, including participants in other funds-transfer systems. For example, a funds transfer may be sent from an originator's bank over the Clearing House Interbank Payments System (CHIPS) to a receiving bank which, in turn, sends a payment order through Fedwire to execute the funds transfer. Similarly, a Federal Reserve Bank may execute a payment order through Fedwire to a receiving bank that sends it through CHIPS to a beneficiary's bank. In the first example, if the originator's bank has notice that Fedwire may be used to effect part of the funds transfer, the sending of the payment order to the receiving bank will be governed by Subpart B. In the second example, if the beneficiary's bank has notice that Fedwire may be used to effect part of the funds transfer, the sending of the payment order to the beneficiary's bank will be governed by Subpart B. In both cases, any funds-transfer system rules adopted by CHIPS would also apply to, at a minimum, the CHIPS portion of these funds transfers. Because Subpart B is federal law, to the extent of any inconsistency, Subpart B will take precedence over any funds-transfer system rule applicable to the remote sender or receiving bank or to a Federal Reserve Bank. However, Subpart B would not apply to a funds transfer sent through a funds-transfer system such as CHIPS where no Federal Reserve Bank handles the funds transfer, even though settlement for the funds transfer is made by means of a separate net settlement or funds transfer through Fedwire.

(c) Operating Circulars.

The Federal Reserve Banks issue Operating Circulars consistent with this regulation that contain additional provisions applicable to payment orders sent through Fedwire. Under Section 4A-107, these Operating Circulars supersede inconsistent provisions of Article 4A. These Operating Circulars are not funds-transfer system rules, but, by their terms, they are binding on all parties covered by this Subpart.

(d) Government senders, receiving banks, and beneficiaries.

This section clarifies that unless a statute of the United States provides otherwise, Subpart B applies to governmental entities, domestic or foreign, including foreign central banks, that act as senders, receiving banks, or beneficiaries of funds transfers through Fedwire.

Section 210.26 -- Definitions.

Article 4A defines many terms (e.g., "beneficiary," "intermediary bank," "receiving bank," "security procedure") used in this Subpart. These terms are defined or listed in Sections 4A-103 through 4A-105. These terms, such as the term "bank" (defined in Section 4A-105(2)), may differ from comparable terms in Subpart A. As Subpart B incorporates consistent provisions of Article 4A, it incorporates these definitions unless these terms are expressly defined otherwise in Subpart B. This Subpart modifies the definitions of two Article 4A terms, "beneficiary's bank" and "payment order." This Subpart also defines terms not defined in Article 4A.

(a) Article 4A.

"Article 4A" is defined to mean the official version of that article of the Uniform Commercial Code and does not refer to the law of any particular state. This official version of Article 4A is incorporated into this Subpart and made federal law for transactions covered by this Subpart.

(b) As of adjustments.

As of adjustments are memorandum items that affect a bank's reserve or clearing balance for the purpose of meeting the required balance, but do not represent funds that can be used for other purposes. As discussed in the Commentary to Section 210.32(b), the Federal Reserve Banks generally provide as of adjustments as a means of effecting interest payments or charges.

(d) Beneficiary's bank.

The definition of "beneficiary's bank" in Subpart B differs from the Section 4A-103(a)(3) definition. The Subpart B definition clarifies that a Federal Reserve Bank that receives a payment order as beneficiary is also the beneficiary's bank with respect to that payment order. In addition, where a Federal Reserve Bank functions as the beneficiary's bank, it need not be identified in the payment order as the beneficiary's bank.

(e) Fedwire.

Fedwire refers to the funds-transfer system owned and operated by the Federal Reserve Banks that is governed by this Subpart. The term does not refer to any particular computer, telecommunications facility, or funds transfer, but to the system as a whole, which may include transfers by telephone or by written instrument in particular circumstances. Fedwire does not include the system used for automated clearing house transfers.

(h) Off-line bank.

Most Fedwire payment orders are transmitted electronically from a sender to a Federal Reserve Bank or from a Federal Reserve Bank to a receiving bank. Banks transmitting payment orders to Federal Reserve Banks electronically are often referred to as on-line banks. Some Fedwire participants, however, transmit payment orders to a Federal Reserve Bank or receive payment orders from a Federal Reserve Bank orally by telephone, or, in unusual circumstances, in writing. A bank that does not use either a terminal or a computer that links it electronically to a terminal or computer at its Federal Reserve Bank to send payment orders through Fedwire is an off-line bank.

(j) Payment order.

(1) The definition of "payment order" in Subpart B differs from the Section 4A-103(a)(1) definition. The Subpart B definition clarifies that certain messages that are transmitted through Fedwire are not payment orders. Federal Reserve Banks and banks participating in Fedwire send various types of messages, relating to payment orders or to other matters, through Fedwire that are not intended to be payment orders. Under the Subpart B definition, these messages, and messages involved with automated clearing house transfers, are not "payment orders" and therefore are not governed by this Subpart. The Operating Circulars of the Federal Reserve Banks specify those messages, other than automated clearing house transfers, that may be transmitted through Fedwire but that are not payment orders.

(2) This Subpart and Article 4A govern a payment order even though the originator's or beneficiary's account may be a consumer account established primarily for personal, family, or household purposes. Under Section 4A-108, Article 4A does not apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act (15 U.S.C. 1693 *et seq.*). That Act, and Regulation E (12 CFR Part 205) implementing it, do not apply to funds transfers through Fedwire (*see* 15 U.S.C. 1693(a)(6)(A) and 12 CFR 205.3(b)). Thus, this Subpart applies to all funds

transfers through Fedwire even though some such transfers involve originators or beneficiaries that are consumers.

Section 210.27 -- Reliance on identifying number.

(a) Reliance by a Federal Reserve Bank on number to identify intermediary bank or beneficiary's bank.

Section 4A-208 provides that a receiving bank, such as a Federal Reserve Bank, may rely on the routing number of an intermediary bank or the beneficiary's bank specified in a payment order as identifying the appropriate intermediary bank or beneficiary's bank, even if the payment order identifies another bank by name, provided that the receiving bank does not know of the inconsistency. Under Section 4A-208(b)(2), if the sender of the payment order is not a bank, a receiving bank may rely on the number only if the sender had notice before the receiving bank accepted the sender's order that the receiving bank might rely on the number. This section provides this notice to entities that are not banks, such as the Department of the Treasury, that send payment orders directly to a Federal Reserve Bank.

(b) Reliance by a Federal Reserve Bank on number to identify beneficiary.

Section 4A-207 provides that a beneficiary's bank, such as a Federal Reserve Bank, may rely on the number identifying a beneficiary, such as the beneficiary's account number, specified in a payment order as identifying the appropriate beneficiary, even if the payment order identifies another beneficiary by name, provided that the beneficiary's bank does not know of the inconsistency. Under Section 4A-207(c)(2), if the originator is not a bank, an originator's bank is not entitled to payment for a payment order if the originator did not have notice that the beneficiary's bank would rely on the identifying number and the person paid on the basis of the identifying payment was not entitled to receive payment. This section of Subpart B provides this notice to entities that are not banks, such as the Department of the Treasury, that are originators of payment orders sent directly by the originators to a Federal Reserve Bank, where that Federal Reserve Bank or another Federal Reserve Bank is the beneficiary's bank (see also Section 4A-402(b), providing that a sender must pay a beneficiary's bank for a payment order accepted by the beneficiary's bank).

Section 210.28 -- Agreement of sender.

(a) Payment of sender's obligation to a Federal Reserve Bank.

When a sender issues a payment order to a Federal Reserve Bank and the Federal Reserve Bank issues a conforming order implementing the sender's payment order, under Section 4A-403, the sender is indebted to the Federal Reserve Bank for the amount of the payment order. A sender, other than a Federal Reserve Bank, that maintains or uses an account at a Federal Reserve Bank authorizes the Federal Reserve Bank to debit that account so that the Federal Reserve Bank can obtain payment for the payment order.

(b) Overdrafts.

(1) In some cases, debits to a sender's account will create an overdraft in the sender's account. A sender does not have a right to such an overdraft. If an overdraft arises, it becomes immediately due and payable at the earliest of: the end of the funds-transfer business day of the Federal Reserve Bank; the time the Federal Reserve Bank, in its sole discretion, deems itself insecure and gives notice to the sender; or the time that the sender suspends payments or is closed by governmental action, such as the appointment of a receiver. In some cases, a Federal Reserve Bank extends its Fedwire operations beyond its cut-off hour for that funds-transfer business day. For the purposes of this section, unless otherwise specified by the Federal Reserve Bank making such an extension, an overdraft becomes due and payable at the end of the extended operating hours. An overdraft becomes due and payable prior to a Federal Reserve Bank's cut-off hour if the Federal Reserve Bank deems itself insecure and gives notice to the sender. Notice that the Federal Reserve Bank deems itself insecure may be given in accordance with the provisions on notice in Section 1-201(27) of the UCC, in accordance with any other applicable law or agreement, or by any other reasonable means. An overdraft also becomes due and payable at the time that a bank is closed or suspends payments. For example, an overdraft becomes due and payable if a receiver is appointed for the bank or the bank is prevented from making payments by governmental order. The Federal Reserve Bank need not make demand on the sender for the overdraft to become due and payable. Once an overdraft is due and payable, a Federal Reserve Bank may exercise its right of set off, liquidate collateral, or take other similar action to satisfy the overdrafting bank's obligation owed to the Federal Reserve Bank.

(2) A sender must cover any overdraft and any other obligation of the sender to the Federal Reserve Bank by the time

the overdraft becomes due and payable. By sending a payment order to a Federal Reserve Bank, the sender grants a security interest to the Federal Reserve Bank in any assets of the sender held by, or for the account of, the Federal Reserve Bank in order to secure all obligations due or to become due to the Federal Reserve Bank. The security interest attaches when the overdraft becomes due and payable. The security interest does not apply to assets held by the sender as custodian or trustee for the sender's customers or third parties.

(c) Notice by sender of use of Fedwire.

If an originator or other sender of a funds transfer sent through Fedwire does not send the payment order directly to a Federal Reserve Bank and does not have notice that Fedwire may be used for a portion of the funds transfer, under Section 210.25(b) this Subpart would not apply to that originator or sender. This section requires a sender sending a payment order directly to a Federal Reserve Bank to warrant to the Federal Reserve Bank that its prior senders have been notified that Fedwire may be used for the funds transfer (see Commentary to Section 210.25(b)).

(d) Review of payment orders.

(1) Under Section 4A-204, a receiving bank is required to refund the principal amount of an unauthorized payment order that the sender was not obliged to pay, together with interest from the date that the receiving bank receives payment. The sender may lose its right to interest if the sender fails to exercise ordinary care to determine that the order was not authorized and notify the receiving bank within a reasonable period of time after the sender receives a notice that the payment order was accepted or that the sender's account had been debited. Similarly, under Section 4A-304, if a sender of a payment order that was erroneously executed does not notify the bank receiving the payment order within a reasonable time, the bank is not liable to the sender for interest on any amount refundable to the sender. Finally, under Section 4A-205, a receiving bank is not liable for losses that could have been avoided if the sender notified the bank within a reasonable period of time after receiving notice from the bank that a payment order that was erroneous was accepted or the sender's account was debited with respect to the payment order. Section 210.28(d) establishes ten funds-transfer business days as the reasonable period of time for the purposes of these provisions of Article 4A.

(2) Section 4A-505 provides that a customer must object to a debit to its account by a receiving bank within one

year after the customer is notified of the debit. Subpart B does not vary this one-year period.

Section 210.29 -- Agreement of receiving bank.

(b) Off-line banks.

(1) Generally, an on-line bank receiving payment orders or advices of credit for payment orders from a Federal Reserve Bank receives the payment orders or advices electronically a short time after the corresponding payment orders are received by the on-line bank's Federal Reserve Bank. An off-line bank receiving payment orders or advices of credit from a Federal Reserve Bank does not have an electronic connection with the Federal Reserve Bank; therefore, payment orders or advices are transmitted either by telephone on the day the payment order is received by the receiving bank's Federal Reserve Bank, or sent by courier or mail along with the off-line bank's daily account statement, on the day following to the day the payment order is received by the off-line bank's Federal Reserve Bank.

(2) Under Section 4A-302(a)(2), a Federal Reserve Bank must transmit payment orders at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date, or as soon thereafter as is feasible. Therefore, where an off-line receiving bank is an intermediary bank or beneficiary's bank in a payment order, its Federal Reserve Bank attempts to transmit the payment order to the off-line bank by telephone on the day the payment order is received by the Federal Reserve Bank. A Federal Reserve Bank can generally identify these payment orders from the type code designated in the payment order.

(3) Under Section 4A-404(b), if a payment order instructs payment to the account of the beneficiary, the beneficiary's bank must notify the beneficiary of the receipt of a payment order before midnight of the next funds-transfer business day following the payment date. Where an off-line bank is the beneficiary of a payment order, telephone notice by a Federal Reserve Bank to the off-line bank of the receipt of the order is not required by Article 4A because the Federal Reserve Bank sends notice to the off-line bank by courier or mail, along with its daily account statement, on the day after the payment order is received by its Federal Reserve Bank. Payment orders for which an off-line bank is the beneficiary of the order are generally designated as settlement transactions.

(4) If an off-line receiving bank maintains an account for another bank, the off-line bank may receive payment orders designated as settlement transactions for credit to the respondent bank as beneficiary, beneficiary's bank or intermediary bank. A Federal Reserve Bank cannot readily distinguish these payment orders from settlement transactions for which the off-line bank is the beneficiary of the order. If an off-line bank notifies its Federal Reserve Bank that it maintains an account for another bank, the Federal Reserve Bank will attempt to telephone the off-line bank with respect to all settlement transactions received by such bank, whether the off-line bank is the beneficiary, the beneficiary's bank, or an intermediary bank in the payment order. Under this section, an off-line bank that does not expressly notify its Federal Reserve Bank in writing that it maintains an account for another bank warrants to that Federal Reserve Bank that it does not hold any such accounts.

(c) Notice by receiving bank of use of Fedwire.

Under Section 210.25(b), this Subpart would not apply to a beneficiary or receiving bank that receives a funds transfer sent through Fedwire but that does not receive it directly from a Federal Reserve Bank, if that beneficiary or receiving bank does not have notice that Fedwire may be used for a portion of the funds transfer. This subsection requires a receiving bank receiving a payment order directly from a Federal Reserve Bank to warrant to the Federal Reserve Bank that all subsequent banks receiving payment orders that are a part of the same funds transfer and the beneficiary of the funds transfer have been notified that Fedwire may be used for the funds transfers that they receive (see Commentary to Section 210.25(b)).

Section 210.30 -- Payment orders.

(a) Rejection.

(1) A sender must make arrangements with its Federal Reserve Bank before it can send payment orders to the Federal Reserve Bank. Federal Reserve Banks reserve the right to reject or impose conditions on the acceptance of payment orders for any reason. For example, a Federal Reserve Bank might reject or impose conditions on accepting a payment order where a sender does not have sufficient funds in its account with the Federal Reserve Bank to cover the amount of the sender's payment order and other obligations of the sender due or to become due to the Federal Reserve Bank. A Federal Reserve Bank may require a sender to execute a written agreement concerning security procedures or other matters before the sender may send payment orders to the Federal Reserve Bank.

(b) Selection of an intermediary bank.

(1) Under Section 4A-302, if a receiving bank, such as a Federal Reserve Bank, accepts a payment order, it must issue a payment order that complies with the sender's order. The sender's order may include instructions concerning an intermediary bank to be used that must be followed by a receiving bank (see Section 4A-302(a)(1)). If the sender does not designate any intermediary bank in its payment order, the receiving bank may select an intermediary bank through which the sender's payment order can be expeditiously issued to the beneficiary's bank so long as the receiving bank exercises ordinary care in selecting the intermediary bank (see Section 4A-302(b)).

(2) This section provides that in an interdistrict transfer, a Federal Reserve Bank is authorized and directed to select another Federal Reserve Bank as an intermediary bank. A sender may, however, instruct a Federal Reserve Bank to use a particular intermediary bank by designating that bank as the bank to be credited by that Federal Reserve Bank (or the second Federal Reserve Bank in the case of an interdistrict transfer) in its payment order, in which case the Federal Reserve Bank will send the payment order to that bank if that bank receives payment orders through Fedwire. A sender may not instruct a Federal Reserve Bank to use its discretion to select an intermediary bank other than a Federal Reserve Bank or an intermediary bank designated by the sender. In addition, a sender may not instruct a Federal Reserve Bank to use a funds-transfer system or means of transmission other than Fedwire unless the sender and the Federal Reserve Bank agree in writing to the use of the funds-transfer system or means of transmission.

(c) Same-day execution.

Generally, Fedwire is a same-day value transfer system through which funds may be transferred from the originator to the beneficiary on the same funds-transfer business day. A sender may not send a payment order to a Federal Reserve Bank that specifies an execution or payment date later than the day on which the payment order is issued, unless the sender of the order and the Federal Reserve Bank agree in writing to the arrangement.

Section 210.31 -- Payment by a Federal Reserve Bank to a receiving bank or beneficiary.

(a) Payment to a receiving bank.

(1) Under Section 4A-402, when a Federal Reserve Bank executes a sender's payment order by issuing a conforming order

to a receiving bank that accepts the payment order, the Federal Reserve Bank must pay the receiving bank the amount of the payment order. Section 210.29(a) authorizes a Federal Reserve Bank to make the payment by crediting the account at the Federal Reserve Bank maintained or used by the receiving bank. Section 210.31(a) provides that the payment occurs when the receiving bank's account is credited or when the payment order is sent by the Federal Reserve Bank to the receiving bank, whichever is earlier. Ordinarily, payment will occur during the funds-transfer business day a short time after the payment order is received, even if the receiving bank is an off-line bank. This credit is final and irrevocable when made and constitutes final settlement under Section 4A-403. Payment does not waive a Federal Reserve Bank's right of recovery under the applicable law of mistake and restitution (see Section 210.32(c)), affect a Federal Reserve Bank's right to apply the funds to any obligation due or to become due to the Federal Reserve Bank, or affect legal process or claims by third parties on the funds.

(2) This section on final payment does not apply to settlement for payment orders between Federal Reserve Banks. These payment orders are settled by other means.

(b) Payment to a beneficiary.

Section 210.31(b) specifies when a Federal Reserve Bank makes payment to a beneficiary for which it is the beneficiary's bank. As in the case of payment to a receiving bank, this payment occurs at the earlier of the time that the Federal Reserve Bank credits the beneficiary's account or sends notice of the credit to the beneficiary, and is final and irrevocable when made.

Section 210.32 -- Federal Reserve Bank liability; payment of interest.

(a) Damages.

Under Section 4A-305(d), damages for failure of a receiving bank to execute a payment order that it was obliged to execute by express agreement are limited to incidental expenses and interest and do not include additional damages, including consequential damages, unless they are provided for in an express written agreement of the receiving bank. This section clarifies that Federal Reserve Banks do not agree to be liable for consequential damages under this provision.

(b) Payment of interest.

(1) Under Article 4A, a Federal Reserve Bank may be required to pay compensation in the form of interest to another party in connection with its handling of a funds transfer. For example, payment of compensation in the form of interest is required in certain situations pursuant to Sections 4A-204 (relating to refund of payment and duty of customer to report with respect to unauthorized payment order), 4A-209 (relating to acceptance of payment order), 4A-210 (relating to rejection of payment order), 4A-304 (relating to duty of sender to report erroneously executed payment order), 4A-305 (relating to liability for late or improper execution or failure to execute a payment order), 4A-402 (relating to obligation of sender to pay receiving bank), and 4A-404 (relating to obligation of beneficiary's bank to pay and give notice to beneficiary). Under Section 4A-506(a), the amount of such interest may be determined by agreement between the sender and receiving bank or by funds-transfer system rule. If there is no such agreement, under Section 4A-506(b), the amount of interest is based on the federal funds rate. Section 210.32(b) provides two means by which Federal Reserve Banks may provide compensation in the form of interest: through an as of adjustment or through an explicit interest payment.

(2) An as of adjustment is a memorandum credit or debit that is applied to the reserve or clearing balance of the bank that sent the payment order to, or received the payment order from, a Federal Reserve Bank. Federal Reserve Banks generally provide as of adjustments to correct errors and recover float. An as of adjustment differs from a debit or credit to an account in that it does not affect the actual balance of the account; it only affects the balance for reserve or clearing balance computation purposes. These adjustments affect the level of reserve or clearing balances that the bank must fund by other means and are therefore an effective substitute for explicit interest payments.

(3) A bank must pass the benefit of an as of adjustment to an originator or beneficiary of a funds transfer that is entitled to compensation in the form of interest from a Federal Reserve Bank under Article 4A. The benefit may be passed on either in the form of a direct payment of interest or in the form of a compensating balance, if the originator or beneficiary agrees to accept the other form of compensation, and the value of the compensating balance is at least equivalent to the value of the explicit interest that would otherwise have been provided.

(4) In certain cases, the party that sent or received a payment order from a Federal Reserve Bank would be unable to

make use of an as of adjustment as compensation in lieu of explicit interest. For example, if the sender or receiving bank is not subject to reserve requirements or satisfies its reserve requirements with vault cash, the as of adjustment could not be used to free other balances for investment. In these cases, the Federal Reserve Bank will provide compensation by an explicit interest payment. Interest would be calculated in accordance with the procedures specified in Section 4A-506(b). Similarly, compensation in the form of explicit interest will be paid to Government senders, receiving banks, or beneficiaries described in Section 210.25(d) if they are entitled to interest under this Subpart.

(c) Nonwaiver of right of recovery.

Several sections of Article 4A allow for a party to a funds transfer to make a claim pursuant to the applicable law of mistake and restitution. Nothing in Subpart B or any Operating Circular issued under Subpart B waives any such claim. A Federal Reserve Bank, however, may waive such a claim by express agreement in order to settle litigation or for other purposes.

Board of Governors of the Federal Reserve System,
June 1, 1990.

(signed) Jennifer J. Johnson

Jennifer J. Johnson
Associate Secretary of the Board