FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **10434**
February 25, 1991]

REGULATION CC

Request for Comment on Same-Day Settlement Proposal

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

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

The Federal Reserve Board has issued for public comment proposed amendments to Regulation CC designed to improve the check collection system. The amendments provide for same-day settlement for checks presented by private sector banks.

Comments are due by June 28, 1991.

The proposed amendments to Regulation CC would require paying banks to settle for checks presented by private-sector banks on the day of presentment, if specified conditions are met.

A check would qualify for same-day settlement under the proposed amendments if it is presented by 8:00 a.m. (local time of the paying bank) at a location of the paying bank designated by the paying bank that is consistent with the check processing region associated with the routing number encoded on the check.

Under the proposed amendments:

- if a bank presents a check in accordance with the time and location requirements for same-day settlement, the paying bank either must settle for the check on the business day it receives the check without charging a presentment fee or must return the check prior to the time for settlement;
- the settlement must be in the form of a credit to the presenting bank's account at a Federal Reserve Bank or in another form agreeable to the presenting bank; and
- unless otherwise agreed, the settlement must occur by the close of Fedwire on the business day the check is received by the paying bank.

In issuing this proposal, the Board has taken into consideration comments received on an earlier proposal that was issued in April 1988.

The Board believes that the proposed amendments provide for more balanced bargaining powers between presenting banks and paying banks and should lead to faster settlement for checks and a more efficient payments system, consistent with the objectives of the Expedited Funds Availability Act.

Enclosed — for depository institutions — is the text of the proposal, as published in the *Federal Register* of February 6; additional, single copies may be obtained at the Bank (33 Liberty Street) from the Issues Division on the first floor, or by calling the Circulars Division (Tel. No. 212-720-5215 or 5216). Comments on the proposal should be submitted by June 28, 1991 and may be sent to the Board, as specified in the notice, or to John F. Sobala, Vice President, Check Function of this Bank.

E. Gerald Corrigan,
President.

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Regulation CC; Docket No. R-0723
Same-Day Settlement Proposal
Comments due June 28, 1991

[Enc. Cir. No. 10434]

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FEDERAL RESERVE SYSTEM

12 CFR Part 229

[Regulation CC; Docket No. R-0723]

RIN 7100-AB01

Availability of Funds and Collection of Checks

AGENCY: Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Expedited Funds Availability Act provides that the Board has the responsibility to regulate the receipt, payment, collection, or clearing of checks in order to carry out the provisions of that Act. Provisions of the Act require the Board to consider proposals to improve the check collection system. Pursuant to this authority, the Board is issuing for comment a proposed amendment to its Regulation CC, Availability of Funds and Collection of Checks, which would require paying banks to provide same-day settlement for checks presented by 8 a.m. local time at specified locations. The proposal would eliminate presentment fees for these checks and thereby facilitate their collection.

DATES: Comments must be submitted on or before June 28, 1991.

ADDRESSES: Comments, which should refer to Docket No. R-0723, 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-C-223 between 8:45 a.m. and 5:15 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 9 a.m. and 5 p.m.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202/452-3874), Julius Oreska, Manager (202/452-3878), or Kathleen M. Connor, Senior Financial Services Analyst (202/452-3917), Division of Reserve Bank Operations and Payment Systems; Oliver Ireland, Associate General Counsel (202/452-3625), or Stephanie Martin, Attorney (202/452-3198), Legal Division. For the hearing impaired *only*: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: As a result of concerns related to the practice of delayed availability—the holds that some depository institutions place on the proceeds of checks deposited into their customers' accounts before the funds may be withdrawn—Congress passed the Expedited Funds Availability Act ("Act") (12 U.S.C. 4001-4010). The Act specifies maximum time limits on the holds that depository institutions may place on funds deposited into transaction accounts.

Prior to enactment of the Act, some depository institutions had argued that their availability schedules reflected the time needed for the collection and return of checks that were not paid and provided a measure of protection against the risk that the depository institution could not recover funds from the depositor if those funds had already been withdrawn from the depositor's account. In part to reduce the risk to depository institutions from the Act's requirements that funds be made available within a certain period of time, Congress granted the Board broad regulatory authority to make improvements to the check collection and return system. Section 609(c) of the Act (12 U.S.C. 4008(c)) provides that the Board, in order to carry out the provisions of the Act, has the responsibility to regulate "any aspect of the payment system, including the receipt, payment, collection, or clearing of checks; and any related function of the payment system with respect to checks." In addition, section 609(b) of the Act (12 U.S.C. 4008(b)) directs the Board to consider proposals to improve the check processing system.

The Board's Regulation CC (12 CFR part 229), which implements the Act, includes a number of provisions designed to accelerate the check return system. In addition to an improved check return process, the Board believes it is also possible to make improvements to the forward collection process in order to lower the costs to collect checks and to improve availability, thus further reducing risk in the check system. Specifically, the Board believes that the forward collection process can be improved by eliminating barriers to presentment that many paying banks [1] impose on private-sector collecting banks. The Board believes that these barriers to presentment have resulted in some inefficient intermediation in the check collection process, to the extent that collecting banks use intermediary collecting banks because the intermediary collecting banks can present checks to paying banks on terms more advantageous than those available to the collecting bank itself.

Therefore, the Board is proposing amendments to Regulation CC that would require paying banks to settle for checks presented by private-sector presenting banks on the day of presentment without the imposition of presentment fees,[2] if specified conditions are met. The proposal provides an 8 a.m. (local time of the paying bank) presentment deadline for same-day settlement for checks presented by private-sector presenting banks. The Board believes that providing for more balanced bargaining power between presenting banks and paying banks should lead to faster settlement for checks and a more efficient payments system, consistent with the objectives of the Expedited Funds Availability Act.

The following discussion includes: (1) A description of the check collection system; (2) objectives used by the Board to evaluate payments system proposals; (3) an explanation of the current inefficiencies in the payments system relevant to this proposal; (4) a description of the same-day settlement concept issued by the Board for public comment in 1988 and a summary of the comments received on the proposal; (5) an explanation of the amendments the Board is proposing today; (6) an economic impact analysis; (7) an assessment of the competitive effects of the proposed rule; (8) a regulatory flexibility analysis; and (9) the regulatory language for the proposed rule.

Background on the Check Collection System

The check collection process involves the movement of checks from the depositary bank to the paying bank and the corresponding movement of the funds represented by the check from the

[1] Regulation CC defines bank to include all depository institutions, including commercial banks, savings institutions, and credit unions. A depositary bank is defined as the first bank to which a check is transferred. A paying bank is a bank by, at, or through which a check is payable and to which it is sent for collection. The Uniform Commercial Code defines collecting bank as a bank, other than the paying bank, that handles a check for collection. An intermediary bank is a bank to which a check is transferred in the course of collection, except the depositary bank or the paying bank. A presenting bank is a bank, other than the paying bank, that presents a check.

[2] Presentment fees are charges that certain paying banks charge private-sector presenting banks when presentment is made. The Federal Reserve Act prohibits Reserve Banks from paying presentment fees.

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paying bank to the depositary bank. The check collection system, which is composed of depositary banks, intermediary collecting banks (including correspondent banks and Federal Reserve Banks), and paying banks, makes use of automated equipment to sort checks, extensive ground and air transportation to move checks, and bank accounting systems.

Approximately 56 billion checks are written annually in the United States. As estimated 30 percent of these checks are deposited in the bank on which they are drawn, and thus are not sent through the check collection system. Of the remaining 70 percent, or 39 billion checks, it is estimated that more than 85 percent are collected on an overnight basis.

The check collection process begins at the depositary bank where checks are deposited by the bank's customers. At the end of each day, the depositary bank posts deposits to its customers' accounts and begins the process of collecting the funds represented by the checks. The depositary bank outsorts the checks drawn on itself (on-us checks) and then sends the remaining checks through the check collection system to the appropriate paying bank.

The depositary bank has several options available for clearing the checks it receives. The check collection paths chosen by each depositary bank are influenced by many factors, including the cost and speed of collection alternatives, the location of the paying bank, the dollar amount of the check, the size and check processing capability of the depositary bank, and the correspondent relationships the bank has established. Depositary banks generally seek to collect checks as quickly as possible to maximize the availability of funds, and larger depositary banks frequently use more than one collection path.

A depositary bank may send a check directly to the paying bank, either by direct presentment or through a clearinghouse arrangement. A clearinghouse is a group of banks, usually in a city or metropolitan area, that has agreed to exchange checks among themselves. The depositary bank may also use an intermediary collecting bank, either a correspondent bank or a Federal Reserve Bank, to complete the check collection process.

A portion of the checks that correspondent banks receive from depositary banks are payable by the correspondent bank. Correspondent banks may also present a portion of the checks received from depositary banks through local clearinghouses. Correspondent banks typically send checks that are not drawn on themselves or that cannot be presented at clearinghouses to which they belong to other correspondent banks or to Federal Reserve Banks for collection or directly to the paying bank, generally pursuant to an agreement with that bank.

Generally, settlement for checks that are presented directly by a private-sector collecting bank will occur by a credit to the account of the collecting bank on the books of the paying bank, or the settlement may occur through the accounts of the collecting and paying banks on the books of the Federal Reserve Banks. Settlement for presentments made through clearinghouse arrangements typically occurs on a net basis through accounts of the participating banks maintained at the Federal Reserve. With respect to checks collected through the Federal Reserve, the Federal Reserve credits the account of the collecting bank on the books of the Reserve Bank; the paying bank's account held at the Reserve Bank is debited in accordance with an automatic-charge agreement.

The Federal Reserve Banks collected about 18.5 billion checks in 1990. Approximately 64 percent of the checks they handle are received from local depositors—banks located in the region served by the particular Federal Reserve office. Nearly ten percent of the checks received by Federal Reserve offices were previously processed by another Federal Reserve office. Another five percent of the checks were deposited initially at another Federal Reserve office under the "consolidated" deposit program.[3] The remaining approximately 21 percent of the checks received by a Federal Reserve office are deposited directly by nonlocal banks without being handled by the depositor's local Federal Reserve office—"direct send" checks.

About 25 percent of all checks handled by the Federal Reserve are deposited in "fine-sort" packages.[4] Approximately 26 percent of the fine-sorted checks are drawn on city banks, 70 percent on regional banks, and 4 percent on country banks.

The Federal Reserve maintains an Interdistrict Transportation System (ITS) that utilizes contracted air and ground transportation to transport checks among Federal Reserve check processing offices. All Federal Reserve offices are interconnected through a "hub and spoke" transportation network that provides each Federal Reserve office a convenient and reliable means to transport checks nationwide. In addition, each Federal Reserve office has a local transportation network to deliver checks from the Federal Reserve office to the paying bank.

Payments System Objectives

An analysis of the potential impact of a proposed same-day settlement rule on payments system participants must consider the effects on public policy objectives for the payments system. Several payments system objectives that were established to provide a framework for the Board's consideration of proposed modifications to the Federal Reserve's payments system risk-control program are also pertinent to this analysis.[5] The objectives are: (1) Lower risk; (2) rapid final payment; (3) lower operating expense of making payments; and (4) equitable treatment of all service providers and users in the payments system.

The risk reduction objective addressed both direct financial risks incurred by the Federal Reserve and private-sector and systemic risk. Systemic risk in the payments system is the risk that the failure of one bank to settle its payments obligations on time and in full will lead to the inability of other banks to meet their payment or other obligations. The risk of settlement failure thus imposes financial risks on other economic agents, in particular payors and payees with unsettled payments and the general creditors of banks, which could, in turn, be unable to meet their obligations.

[3] Checks deposited under the consolidated deposit program are not processed by the automated sorting equipment at the depositing bank's Federal Reserve office, because the checks are deposited in cash letters sorted by availability zone of the receiving Federal Reserve office or by paying bank.

[4] A fine-sort package includes checks that are to be presented to a particular paying bank. In the case of fine-sort packages, the Federal Reserve office would not use automated equipment to process the individual checks, but would instead sort and deliver the package of checks to the appropriate paying bank.

[5] Board of Governors of the Federal Reserve System; "Controlling Risk in the Payments System: Report of the Task Force on Controlling Payments System Risk to the Payments System Policy Committee of the Federal Reserve System"; August 1988. The report included two additional payments system objectives that are not directly relevant to this analysis. These objectives are: Ensuring effective tools for conducting monetary policy; and facilitating low transaction costs for the Treasury securities market.

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The second objective relates to improving the speed of final payment. Rapid final payment is desirable because it promotes the efficient exchange of goods, services, and financial instruments, and facilitates the financing of such transactions by minimizing the need for short-term working capital, including intraday credit. This objective also embodies the legal notion that those economic agents who are entitled to funds should receive payment and final settlement in a timely manner.

The objective of lower operating expense addresses the real resource costs associated with handling payments. Such costs are incurred as a result of handling checks and, all other things equal, increases as the number of intermediaries in the collection process increases, because certain operating steps must be repeated each time an additional party handles a check.

Equitable treatment of all service providers and users promotes competition in the payments system. The Board believes that competition is an important means of promoting the efficiency of the payments system. Generally, a competitive environment provides incentives for payment service providers to increase the quality of their services, while minimizing their costs, and thus serves to promote efficiency in the payments system.

Current Inefficiencies in the Check Collection Process

It is possible that the current set of legal and institutional arrangements introduces inefficiencies in the check collection process. There are differences between the abilities of Federal Reserve Banks and private-sector collecting banks to present checks to paying banks for same-day settlement. Today, Federal Reserve Banks generally receive same-day settlement for checks presented to paying banks prior to 2 p.m. by debiting the paying bank's account or the account of a correspondent settlement agent held at a Federal Reserve Bank. The General Accounting Office found that private-sector banks, such as correspondent banks, frequently are unable to obtain settlement terms as favorable as those available to the Federal Reserve.[6] Some paying banks impose barriers to presentment, including presentment fees and requirements to maintain balances at the paying bank or settlement by remittance draft, which itself requires collection, that slow the speed or increase the cost of the forward collection of checks. Banks impose these barriers to obtain an additional source of revenue, to facilitate the provision of controlled disbursement services to their corporate customers,[7] to delay the presentment of checks, and/or to govern the timing of check presentments so as to maximize the efficient use of processing resources.

Presentment of and settlement for checks between banks is governed generally by Articles 3 and 4 of the Uniform Commercial Code (UCC). While the UCC does not explicitly sanction the use of barriers to same-day settlement, neither does it explicitly prohibit them. Thus, delayed settlement for checks between banks or the payment of presentment fees to obtain same-day settlement has become a common business practice despite the fact tht most checks are payable on demand.

In order to obtain same-day settlement, private-sector presenting banks commonly pay presentment fees when they present checks to certain paying banks. Proponents of presentment fees maintain that the fees either discourage presentments after locally established clearinghouse deadlines, thus allowing paying banks to operate more efficiently by controlling the timing of the work flow in their check operations, or offset the cost of processing checks that are presented after the deadlines. Presentment fees, however, often do not reflect a service rendered to the collecting bank by the paying bank, and may discourage the most economically efficient presentment of checks by encouraging greater intermediation to avoid the imposition of presentment fees and related balance requirements.[8]

If a collecting bank attempts to present checks directly rather than use intermediation channels that increase real resource costs, it may incur other costs, in addition to presentment fees, that are imposed by the paying bank. Some paying banks impose other barriers to presentment that increase the collection costs of presenting banks and that may result in increased revenue for themselves.

For example, when presenting banks present checks to paying banks without having established account relationships, paying banks may settle in the form of a remittance draft drawn on another bank. This form of settlement can further delay the availability of funds to the presenting banks for a day or more because the remittance draft is subject to the same type of collection process as the original checks. This type of settlement results in an opportunity cost to the presenting bank because these funds could have been used for investment purposes.

To avoid receiving settlement for checks by remittance draft, a presenting bank may need to establish an account relationship with a paying bank. The presenting bank would present checks to the paying bank and receive settlement for the checks through credit to its account. Under the terms of the UCC, the paying bank must settle by midnight of the day of deposit in order to be able to return the checks the following day. Through terms of its agreement with the presenting bank, however, the paying bank may delay the presenting bank's use of those funds and may charge account maintenance fees to the presenting bank. The delay in availability of these funds represents an opportunity cost to the presenting bank and the account maintenance fees increase the presenting bank's costs to collect checks.

Barriers to presentment may result in inefficient intermediation in the check collection process. The Board believes that the differences in presentment abilities among collecting banks have resulted in some inefficient intermediation in the check collection process because more checks are collected through the Federal Reserve Banks, and to a lesser extent, through correspondent banks, than would be the case if private-sector collecting banks could obtain settlement for checks on the day of presentment without being subject to presentment fees and other barriers to presentment. If all collecting banks had equal presentment abilities, banks would choose to use intermediary banks due primarily to the economies of scale with respect to processing, transportation, and/or settlement that the intermediaries could pass on to their collecting bank customers. For example,

[6] United States General Accounting Office, "Check Collection: Competitive Fairness is an Elusive Goal", May 1969.

[7] Banks offering controlled disbursement services notify their corporate customer early in the day of the amount of the corporation's check payments that have been presented that day.

[8] The primary constraint on the level of presentment fees assessed by a paying bank is the fine sort or High Dollar Group Sort fee assessed by the Federal Reserve to collect a check on that bank. There is no other competitive pressure to limit the level of presentment fees, since a bank is in a monopoly position with respect to checks for which it is paying bank.

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intermediary banks handle large numbers of checks from a diversity of sources and thereby can optimize the use of fixed cost resources, such as transportation. Spreading these fixed costs across a larger number of checks allows intermediary banks to offer check collection services at a lower cost per check.

The decision to use an intermediary collecting bank and the choice of which intermediary bank to use is influenced in many cases, however, by the intermediary collecting bank's ability to present checks to paying banks on terms more advantageous than those available to the collecting bank itself. For example, a bank may collect some checks through the Federal Reserve because of the Federal Reserve's ability to obtain same-day settlement from the paying bank without the imposition of presentment fees. Similarly, a bank may collect certain checks through a correspondent bank because that correspondent bank receives same-day settlement from some paying banks through clearinghouse arrangements or through individual agreements, although the agreements may be conditioned on the payment of presentment fees and the maintenance of balances by the correspondent bank at the paying bank.

The Board believes that the use of intermediary collecting banks because of the economies of scale that those banks bring to the check collection process generally enhances the efficiency of the payments system. To the extent that intermediary collecting banks system inefficiencies may result.

In addition to the inefficiencies described above, further payments system inefficiencies may result from the use of checks, rather than electronic payments, as the dominant noncash method of payment. Checks can take longer to clear than electronic payments and are generally more costly to process. However, the choice of payment method generally rests with the originator of the payment and the inherent inefficiencies of check payments (e.g., float, particularly the time between issuance of a check and deposit of the check in the banking system) provides incentives for continued reliance on the check mechanism by the drawer of the check.

1988 Request for Comment and Summary of Comments

In April 1988, the Board issued for public comment a concept whereby paying banks would be required to pay for checks presented by any presenting bank prior to 2 p.m. local time in same-day funds, without the imposition of presentment fees (53 FR 11911, April 11, 1988). The proposed concept would have given private-sector collecting banks essentially the same presentment abilities as Federal Reserve Banks. The Board requested comment to help determine the operational effects of the proposed concept.

The Board received 1,148 comments on the proposed concept. A number of the responses were not included in this analysis because they were duplicates or requests for extension of the comment deadline or were combined because they represented multiple responses from the same organization. The table below summarizes the 800 responses included in this analysis.

Category of respondent	Number of responses		
	Total	Support	Oppose
Commercial banks and BHCs	118	26	92
Savings institutions and credit unions	76	4	72
Trade associations and clearinghouses	16	4	12
Corporations	556	6	550
Cash management associations	8	0	8
FRBs, FHLBs, Governments, Misc.	26	0	26
Total	800	40	760

Ninety-five percent of the commenters opposed the concept as proposed. The principal concerns of the commenters centered on the problems associated with permitting presentment of checks as late as 2 p.m. Approximately 70 percent of the comments were from corporations that believed that the proposed 2 p.m. presentment deadline would severely disrupt, if not put an end to, corporate cash management and controlled disbursement services. Currently, banks provide certain corporate customers with information regarding the amount of the corporation's check payments that have been presented early enough each day for the corporation to invest surplus balances or borrow additional funds, as necessary, while money markets are still active. Commenters noted that presentment of corporate checks as late as 2 p.m. could disrupt such arrangements because of corporations' needs for payment data early in the day.

Generally, bank commenters echoed the concerns raised by corporate customers. In addition, banks expressed concern about the increased cost, operational complexity, and disruption that would be caused by receipt of checks later in the day. Community bank and savings institution commenters generally believed the same-day settlement concept would benefit only larger commercial banks. In particular, these commenters were concerned with the increased costs and complexity associated with receiving presentments from multiple presenting banks.

Twenty commenters were concerned that they would lose control in a same-day settlement environment over the place of presentment for checks by private-sector presenting banks. Savings institutions preferred that checks be presented only at locations designated by the paying bank and not at any branch location chosen by the presenting bank. Credit unions were concerned about the presentment of payable-through checks directly to the credit union rather than to the credit union's designated payable-through bank. Comments by all types of banks indicated that they were not prepared to accept and process large quantities of checks at locations where they do not have check processing capabilities.

Commenters also noted that paying banks need to schedule operational resources to handle checks presented each day, and indicated that a presenting bank should be required to notify a paying bank of its intent to present cash letters directly. This prenotification was seen by some commenters as an important aspect of any same-day settlement rule.

Seventeen commenters stated that the establishment of a workable settlement system was important for the success of a same-day settlement system. Five commenters suggested that Federal Reserve accounts be used exclusively to effect settlement, whereas six commenters suggested using correspondent accounts exclusively. Other commenters believed that a mixture of settlement options would be most appropriate.

Some commenters mentioned the need to minimize transportation expense and indicated that the Federal Reserve should make its transportation network available for use by private-sector presenting banks. Specifically, these commenters suggested that private-sector presenting banks be allowed to utilize the transportation arrangements, both ITS and local transportation systems, that the Federal Reserve has established to deliver checks it collects.

Eight commercial bank commenters

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expressed concern about the risk associated with making settlement for cash letters, in immediately available funds, to banks with which they were unfamiliar and had no continuing business relationship. In particular, seven commenters expressed concern regarding the risk that the paying bank would not be able to obtain settlement for returned checks and adjustments against a failed depositary bank that presented checks directly to the paying bank.

Twenty-nine commenters stated that a same-day settlement rule could potentially overload the Fedwire system because of the large number of wire transfers that would be made to settle for checks that would be presented by private-sector presenting banks. Many of these commenters forecast that the volume of settlement transfers would create gridlock on the wire system.

In its request for comment, the Board asked what modifications could be made to the proposed same-day settlement concept that would minimize the problems that were envisioned and would improve the efficiency of the forward collection process. Most alternatives suggested by the commenters focused on establishing an earlier-in-the-day presentment deadline. Many commenters viewed an earlier deadline as necessary to accommodate the timely provision of payment data to corporate customers and the operations of paying banks. Twenty-eight commercial bank commenters stated that they preferred to receive physical presentment of their checks prior to 12 noon. Banks providing cash management services to corporations favored the receipt of the payment data related to their corporate accounts much earlier than noon. Generally, these banks indicated that they must receive corporate check payment data before 9 a.m. Thirteen commercial bank commenters that provide cash management services suggested that early delivery of the corporate payment data could be accomplished by electronic transmission of the data by the presenting bank to the paying bank. Commenters stressed the need for standardization of data reporting formats so that a paying bank could readily utilize the data reported by presenting banks. Five commenters located on the west coast suggested a uniform national presentment deadline (e.g., 10 a.m. Eastern Time) to allow west coast banks to better compete for the controlled disbursement business of large corporations.

The Association of Reserve City Bankers (ARCB) proposed an alternative same-day settlement approach that would phase in the implementation of a same-day settlement environment. The ARCB recommended that during Phase I, which would be in effect for a minimum of two years, the presentment deadline would be tied to the High Dollar Group Sort or City unsorted deadline of the paying bank's Federal Reserve office, but would be no earlier than 8:30 a.m. local time of the paying bank. During this phase, electronic transmission of payment data would not be required and presentment fees would not be allowed prior to the established deadline. Under Phase II, the presentment deadline would be extended to noon local time of the paying bank. Banks presenting checks after the deadline established in Phase I but before noon would have to provide an electronic transmission of the payment data by 9:30 a.m. Eastern Time if requested by the paying bank. Phase III would follow the successful implementation of Phase II and would extend the presentment deadline to 2 p.m. local time of the paying bank, provided electronic transmission of the data was made available by 9:30 a.m. Eastern Time for presentments not received by the paying bank by the Phase I deadline.

After analyzing the comments received, Board staff obtained input from an informal advisory group consisting of representatives of commercial banks, savings institutions, credit unions, check clearinghouses, corporate cash managers, Federal Home Loan Banks, and Federal Reserve Banks. The advisory group participants had differing views regarding whether the Board should pursue further the development of a same-day settlement rule, and if so, how the rule should be structured. Some participants believed that the Board should not adopt a modified same-day settlement rule, but nonetheless provided input to the design of a modified rule in the event the Board determined that a revised same-day settlement concept should be pursued.

One of the key issues discussed by the advisory group was the presentment deadline that should be established in a same-day settlement rule. The group debated whether the rule should establish a uniform national presentment deadline, or whether the presentment deadline should be based on the local time of the paying bank. The majority of the group indicated that a deadline of 8 a.m. local time of the paying bank, without the imposition of presentment fees, was an appropriate base for development of a revised same-day settlement proposal. In addition, the group considered the issue of electronic delivery of payment data prior to physical presentment of the checks. The group suggested that the Board's proposal discuss, and request public comment on, the concept of an enhanced same-day settlement rule, which would provide for a later pesentment deadline if the presenting bank made available to the paying bank electronic delivery of payment data earlier in the day.

The majority of the group indicated that the paying bank should be required to designate as its presentment point an office of the bank that is in the same (or better) availability zone of the check processing region consistent with the routing number on the check. A majority of the group believed that a paying bank should be able to designate a location, other than an office of the paying bank, as its presentment point. The group observed that the paying bank could agree with the presenting bank to accept checks that are presented at an alternate location (such as at an intercept processor) and that such agreements would often be advantageous to both parties.

The group discussed a number of issues related to providing check information to the paying bank electronically. For example, some participants suggested that the American Bankers Association's Routing Number Advisory Board should be requested to consider the issuance of unique routing numbers for checks for which the paying bank would require information transmitted electronically as a condition to later-in-the-day presentment. They believed that separate identification of these checks would enable presenting banks to reduce significantly the transmission times for check data under an enhanced same-day settlement arrangement. The group also recommended that transmission of MICR-line [9] data should not constitute presentment, except by agreement of the paying bank. The group agreed that the American Standards Committee X-9 Committee should be requested to develop industry standards for communicating check payment data among banks.

[9] The MICR (Magnetic Ink Character Recognition) line is the machine-readable information printed along the bottom of the check.

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The group suggested that, in addition to settlement by wire transfer or through correspondent accounts, the Federal Reserve Banks should provide a settlement service that could be used to settle for check presentments under a same-day settlement rule. As envisioned by the group, the settlement service would provide for settlement on the books of the Federal Reserve based on instructions from the presenting bank, rather than the paying bank.

The group discussed a number of issues relating to the risks involved in participation in same-day settlement arrangements. The group identified as the principal risk to the paying bank the risk associated with failure of the presenting bank after settlement has been made for checks presented but prior to the settlement of any related returned checks and adjustments. The group concluded that the paying bank would have little control over its risk associated with a failure of the presenting bank.

The group also discussed when on the day of presentment the paying bank must settle for checks presented under a same-day settlement rule. They indicated that this issue was linked to the Board's consideration of when check presentments made by Reserve Banks would be debited to the paying bank's reserve or clearing account at the Federal Reserve for the purpose of measuring intraday balances to determine whether a bank has incurred a daylight overdraft. They believed that if the Board adopted the proposal it had initially issued for public comment (54 FR 26094, June 21, 1989), which would provide for end-of-day posting of check debits, paying banks similarly should be obliged to settle for checks presented by private-sector presenting banks by the close of business on the day of presentment. However, the group indicated that if the Board adopted an earlier-in-the-day posting time for checks presented by the Federal Reserve, it should request comment on whether an earlier time should also be adopted for presentments by private-sector banks.

The group believed that standards for deposits and adjustments should be established for presentments made under a same-day settlement rule. However, most participants on the advisory group believed that these standards should be developed as industry standards and not be incorporated in a same-day settlement rule because of their technical nature and because they would likely evolve over time as check collection practices changed. The group believed that it would be desirable to establish a mechanism for setting and enforcing standards for cash letters presented under the same-day settlement rule. The group suggested that the following may represent appropriate deposit requirements:

- A presentment must consist of at least 300 checks or be of a dollar value of at lest $50,000.
- Multiple routing numbers of the same bank may be commingled in a single cash letter.
- Cash letters must be clearly marked and meet specified packaging standards.
- Cash letters must meet minimum quality standards or be subject to deferred settlement.

Among the requirements suggested by the group for adjustments to cash letters handled under a same-day settlement rule were:

- The minimum amount of an adjustment entry would be $15.00, with smaller amounts absorbed by the bank.
- Reporting and resolution of adjustments must meet timeliness standards.
- Data required to be included on forms for reporting errors in cash letters must be standardized.

The Federal Reserve Banks also have provided input regarding whether the Board should pursue the development of a same-day settlement rule. In general, the Reserve Banks envision possible significant changes in collection patterns in a same-day settlement environment that would reduce the volume of checks they collect. Moreover, the Reserve Banks anticipate that a larger proportion of their check volume would consist of checks drawn on remote, low-volume endpoints. The Reserve Banks noted that a signficant reduction in Reserve Bank check volume would likely lead to increases in their check collection fees, as the fixed costs associated with the check service are spread across smaller volume. Depending on the degree of change in current check collection patterns, the Reserve Banks have expressed concern that, in a same-day settlement environment, it may become increasingly difficult for them to provide an adequate level of check services to all banks and, at the same time, to comply with the Board's pricing principle established pursuant to the Monetary Control Act to match costs and revenues for the check service. They also expressed concern that a significantly reduced Reserve Bank operational presence could impair the Federal Reserve's ability to stimulate innovation and otherwise promote the efficiency and integrity of the check payments system, and in particular to spur the conversion of checks to electronic payments.

The Board has analyzed the concerns raised by the commenters and the advisory group and has considered the alternatives and the suggestions that have been made to improve the efficiency of the forward collection system. The Board has developed, and is issuing for comment, a specific regulatory proposal to require same-day settlement for presentments by private-sector presenting banks.

Proposed Amendments

The Board's proposed amendment to Regulation CC would require paying banks to settle for checks presented by private-sector collecting banks on the day of presentment if specified conditions are met. Settlement for checks presented by Federal Reserve Banks would continue to be governed by Subpart A of Regulation J (12 CFR part 210).[10] The Board is proposing an 8 a.m. presentment deadline (local time at the location of the paying bank designated as the place of presentment) for same-day settlement of checks presented by private-sector presenting banks. Under the proposed rule, presenting banks and paying banks may agree that presentment of checks subject to same-day settlement could occur later in the day, perhaps on the condition that the presenting bank transmit MICR-line data from the checks by a specified time in the morning, thereby enabling the paying bank to provide cash management services to their corporate customers.

A check would qualify for same-day settlement if it is presented at a location of the paying bank designated by the paying bank. The proposal would not apply to checks presented for immediate payment over the counter.[11] The paying

[10] Section 210.9(a) of Regulation J provides that a paying bank is accountable for a check presented by a Federal Reserve Bank unless it settles for the check by the close of the paying bank's banking day and that proceeds of the settlement must be available to the Reserve Bank by the close of the Reserve Bank's banking day. Although a Federal Reserve Bank could avail itself of a Regulation CC same-day settlement requirement, because Regulation J provides for same-day settlement for checks not covered by the proposed Regulation CC amendment, it is unlikely that a Federal Reserve Bank would rely on the Regulation CC provision.

[11] Under the proposed same-day settlement rule, a paying bank must settle for checks presented by 8 a.m. at the designated location by Federal Reserve

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bank must designate a presentment location that is in the check processing region consistent with the routing number in the MICR line of the check. If the paying bank does not designate a presentment location, it must accept presentment for same-day settlement at any location identified in § 229.36(b) of Regulation CC, i.e., at an adress of the bank associated with the routing number on the check, at any branch or head office if the bank is identified on the check by name without address, or at a branch, head office, or other location consistent with the name and address of the bnank on the check if the bank is identified on the check by name and address. A paying bank that uses more than one routing number associated with a single check processing region may designate one or more locations in that check processing region at which checks will be accepted for same-day settlement, but the paying bank must accept any checks with a routine number associated with that check processing region at each designated location.

A paying bank and a presenting bank may agree that checks will be accepted for same-day settlement at alternative locations (e.g., at an intercept processor). For example, a paying bank could agree to accept presentment at different locations from different presenting banks, or a presenting bank could agree to present checks for same-day settlement at the location of an operations center of a subsidiary or affiliate of the paying bank. The Board anticipates that, in many cases, alternative locations may be advantageous to the presenting bank as well as the paying bank, because the presenting bank may be able to present checks of a number of paying banks at the alternative location, and the alternative location may be more centrally located than the location of the paying bank.

In the case of a check payable through a bank but payable by another bank, this proposal would not authorize direct presentment to the bank by which the check is payable. The requirements of same-day settlement would apply to the payable-through bank to which the check is sent for payment or collection.

The Board's proposal does not require a presenting bank to give advance notification to the paying bank that it will present checks for same-day settlement. The Board believes that, in practice, presenting banks will contact paying banks to determine the location of the paying bank's presentment point for same-day settlement, and this contact will serve to notify paying banks of future check presentments. The Board also beleives that presenting banks and paying banks generally will agree to the details of the same-day settlement arrangement and that unexpected presentments for same-day settlement will be rare.

Both presenting banks and paying banks would be held to a standard of good faith, defined in proposed § 229.2(mm) as "honesty in fact and the observance of reasonable commercial standards of fair dealing." The proposed definition is consistent with the good faith definition in UCC section 3–103(a)(4) as recently revised by the National Conference of Commissioners on Uniform State Laws and the American Law Institute. For example, designating a presentment location for the primary purpose of discouraging banks from presenting checks for same-day settlement might not be considered good faith on the part of the paying bank. Similarly, presenting a large volume of checks without prior notice could be viewed as not meeting reasonable commercial standards of fair dealing and therefore may not constitute presentment in good faith.

Under the proposal, if a bank presents a check in accordance with the time and location requirements for same-day settlement, the paying bank either must settle for the check on the business day it receives the check without charging a presentment fee or return the check prior to the time for settlement. Thus, if a paying bank wishes to return a check rather than make same-day settlement for the check, ordinarily it may not retain the check past the close of Fedwire on the day of presentment. This return deadline, however, would be subject to the extension provisions of § 229.30(c) of Regulation CC. The Board is proposing regulatory amendments and commentary revisions to that section to make explicit the paying bank's ability to use the deadline extension provisions when returning a check in lieu of settling for it, as well as when returning a check after having already settled for it.

The settlement must be in the form of a credit to an account at a Federal Reserve Bank designated by the presenting bank (e.g., a Fedwire transfer). The presenting bank may agree to accept settlement in another form, such as credit to an account of the presenting bank at the paying bank or debit to an account of the paying bank at the presenting bank. Unless otherwise agreed, the settlement must occur by the close of Fedwire on the business day the check is received by the paying bank.

Checks presented to a bank for same-day settlement should be separately sorted from checks deposited with that bank for collection. If a bank that provides correspondent services to another bank receives a mixed cash letter from the respondent bank that includes checks for which the correspondent bank is the paying bank that would otherwise meet the requirements for same-day settlement under this section, the correspondent bank may charge a fee for handling those checks and need not make settlement in accordance with terms of the proposal. In the case of a sorted cash letter received by a correspondent bank from a respondent bank containing only checks for which the correspondent bank is the paying bank and which meet the requirements for same-day settlement, the correspondent may not charge a fee for handling those checks and must make settlement in accordance with the terms of the proposal.

The proposed requirement that a paying bank settle for a same-day settlement check by the close of Fedwire is similar to Regulation J's requirement that a paying bank make settlement proceeds available for a check presented by a Federal Reserve Bank by the close of the Reserve Bank's banking day on the day of presentment (12 CFR 210.9(a)(2)). To accurately measure daylight overdrafts on Fedwire, the Board has issued for comment a posting scheme under which non-wire payments, such as checks, would be posted at various times throughout the business day. To avoid the intraday float that would be created by posting credits for checks earlier in the day, the Board proposed an amendment to Regulation J to allow the Reserve Banks to debit paying banks' accounts earlier in the day for checks presented that day (56 FR 3047, January 28, 1991). The proposed settlement time for checks presented by the Federal Reserve would be the later of one hour after physical presentment of the checks or one hour after the opening of Fedwire, or such later time as provided in the Reserve Bank's operating circular. Thus, if Regulation J were to be amended, Federal Reserve Banks would be able to

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credit by the close of Fedwire on the day of presentment, or as otherwise agreed, in order to preserve the right to return the checks the next day (subject to the deadline extension in § 229.30(c)). When checks are presented over the counter for immediate payment and payment is made, the checks are finally paid and may not be returned.

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obtain settlement from paying banks earlier in the day than would private-sector presenting banks under the same-day settlement rule proposed in this docket. The Board requests comment on whether the time by which paying banks must settle for checks under the same-day settlement rule should conform to the time by which paying banks must settle for checks with Federal Reserve Banks under any future Regulation J amendment and whether paying banks would be operationally equipped to make same-day settlement with private-sector presenting banks within one hour after presentment or one hour after the opening of Fedwire, whichever is later.

The proposed same-day settlement rule recognizes that there may be certain business days that are not banking days for the paying bank. Some paying banks may continue to accept presentment of checks on such days (e.g., by opening their back office operations or by accepting presentment at a night depository or at an intercept processor) and to settle for the checks. In other cases, a paying bank may be unable to accept presentment of checks on such a day, or may be able to accept presentment but not be able to settle for the checks. In these latter cases, if the paying bank is closed voluntarily, the Board proposes that the paying bank must accept presentment of and settle for the checks by its next banking day and must pay interest compensation to the presenting bank for the value of the float associated with the delayed settlement. The Board has proposed an amendment to § 229.2 to define "interest compensation" as an amount of money calculated at the Federal Funds rate as provided in § 4A–506(b) of the UCC.

The proposed same-day settlement rule does not specify adjustment standards or other technical details, such as cash letter quality standards. The Board believes that resolution of these issues should not be imposed by federal regulation but can be more efficiently worked out between presenting banks and paying banks within the context of the good faith standard.

The Board realizes that, while a collecting bank would have a choice whether or not to present directly to a particular paying bank for same-day settlement, a paying bank would have no choice under the proposal but to settle for same-day settlement checks as provided in the regulation. As the paying bank often will not have the time to verify the contents of the cash letter, the settlement will generally be made on the basis of the stated cash letter total. This total may be overstated due to error on the part of the presenting bank. Failure to settle for the full amount of the cash letter raises the risk that the paying bank will lose the right to return checks it receives in the cash letter. Consequently, the paying bank, by settling for the stated amount of the cash letter, would bear a risk, not of its own choice, that the presenting bank would be unable or unwilling to process adjustments for excess payments for same-day settlement cash letters.

Under the common law right of set-off, generally a settlement owed to a presenting bank may be set off by adjustments for previous excess settlements with the presenting bank. Should a presenting bank become insolvent, however, there is a risk that post-insolvency debts to a failed presenting bank in receivership would not be allowed to be used to offset pre-insolvency debts of the failed bank, due to lack of mutuality of parties. In additions, set-off may be an ineffective means of recouping adjustments if the paying bank does not receive presentment from the presenting bank on a regular basis or if the amount of the adjustment exceeds and amount of the average presentment. To help alleviate this risk, the Board has proposed amendments to Regulation CC to require the presenting bank to warrant the accuracy of the cash letter total to the paying bank, and to create a preference for the paying bank for adjustments against a closed presenting bank.

The proposed amendment to § 229.34 of Regulation CC would require the presenting bank to warrant to the paying bank that the total of the checks presented, as noted on the cash letter, equals the total value as stated by the MICR encoding on the checks presented.[12] The proposal does not include a warranty as to the accuracy of the encoding on each check (i.e., that the value of the check as encoded on its MICR line is equal to the face value of the check). Section 4–209 of the UCC Article 4, as recently approved by the National Conference of Commissioners on State Laws and the American Law Institute, provides that a person who encodes information on an item after issue warrants to subsequent collecting banks and to the payor bank that the information is correctly encoded, and if a customer of the depositary bank encodes, that bank also makes the warranty. Thus, in states that adopt the new Article 4, banks will make waranties to cover encoding accuracy and these warranties will extend to all of the banks in the forward collection chain.

The proposed warranty would apply with respect to all check presentments and is not limited to presentments made in accordance with the proposed same-day settlement rule. The proposed warranty would give a paying bank a cause of action against a presenting bank that does not reimburse the paying bank for adjustments and should encourage presenting banks to take care in stating the value of cash letters. Under proposed § 229.34, damages could include the amount of the adjustment, plus interest compensation (as defined in proposed § 229.2(nn)) and expenses related to the adjustment. The Board requests comment on whether this warranty should be extended to apply to any bank in the check collection or return chain that receives settlement for checks or returned checks or whether the warranty should be limited to checks presented for same-day settlement in accordance with proposed § 229.36(f).

The Board is also proposing an amendment to § 229.39 of Regulation CC that would give a paying bank a preferred claim against a closed presenting bank in the event that the presenting bank does not reimburse the paying bank for adjustments owed to the paying bank. This preference would be available to paying banks versus presenting banks in all presentment situations and would not be limited to presentments made in accordance with the same-day settlement rule. The Board requests comment on whether this preference for paying banks should be limited to presentments for same-day settlement in accordance with proposed § 229.36(f) or, alternatively, whether any bank in the forward collection or return chain that receives and settles for checks should have a preferred claim for adjustments versus the bank with which it settled.

The proposed preference applies to adjustments to a settlement made by the paying bank that is in excess of the value of the checks presented. The proposed preference would extend to adjustments for inaccurate cash letter totals (warranted under § 229.34(c)) as well as to adjustments for encoding errors (warranted under revised UCC section 4–209. The Board requests comment on whether Regulation CC

[12] If the Board adopts this amendment, the Reserve Banks may amend their operating circulars to require banks, as a condition of depositing fine-sort packages, to provide a similar warranty to the Reserve Bank.

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should provide a security interest to the paying bank in the proceeds of the settlement paid to the presenting bank, rather than the proposed preference.

The Board's proposal does not include all of the alternatives suggested by the commenters. For example, the proposal does not include a plan discussed by the informal industry advisory group that would phase in later presentment deadlines coupled with early-in-the-day electronic transmission of the check payment information (explained more fully in the summary of comments on the 1988 proposal above). The Board believes, however, that this plan would likely result in a larger number of checks presented for same-day settlement and would encourage the use of electronics in the check system. The Board also believes that this plan could be implemented by agreement under the same-day settlement rule as proposed. As discussed below in the Economic Impact Analysis, the Board believes that the proposed rule will bring about more balanced bargaining powers between paying banks and presenting banks, which may induce agreements between paying banks and presenting banks that would allow for later presentment under certain conditions. Consequently, the Board believes that it is premature to consider additional changes to presentment requirements before market forces have an opportunity to take effect. The Board would monitor market development under a same-day settlement rule to determine whether further regulatory action would be warranted.

Proposed Federal Reserve Bank Services

In the near future, the Board anticipates that it will consider proposed Federal Reserve Bank services that would be offered to facilitate check collection and payor bank services [13] in a same-day settlement environment. The proposed services are not being considered by the Board at this time because Reserve Bank staff needs the opportunity to review the proposed services in light of these proposed amendments to Regulations CC. The Board plans to request that comments on these proposed Federal Reserve Bank services be submitted to the Board by the same date as comments on these proposed amendments.

Economic Impact Analysis

The Board has devised an analytical framework for conducting an economic analysis of the potential impact of the proposed same-day settlement rule on payments system participants. The objectives of the analysis are to assess the effects of the proposal on the payments system and its individual participants and to assess the overall costs and benefits of a same-day settlement rule.

The proposed same-day settlement rule would likely change the amount of intermediation in the check collection process. The analytical framework described below considers the direct effects of the proposed rule on the level of intermediation and the primary derivative effects on check collection costs, prices, and market shares. In addition, the analytical framework describes the potential effects of a same-day settlement rule on clearinghouses, paying banks, and bank customers.

The Board requests comment on the analytical framework and on the actual economic effects of the proposed same-day settlement rule. Specifically, the Board requests that commenters indicate whether they agree with the qualitative analysis suggested by the framework and identify any effects on payments system participants that have not been addressed in this analysis. The Board also requests that commenters provide quantitative information on the individual projected effects of the proposed rule and on the anticipated effects of the rule on the payments system more broadly defined. The Board will consider this information in its analysis with respect to final action on the proposal.

The Board believes the proposed same-day settlement rule furthers the previously discussed objectives used by the Board to evaluate payments system proposals. To the extent that implementation of the proposed same-day settlement rule accelerates the forward collection process, the proposed rule should result in both lower risk and an improvement in speed of final payment. The proposed rule also should result in reduced reliance on intermediary banks (where the intermediary banks do not provide economies of scale that enhance the efficiency of the check collection process) and thus lead to lower operating expense. Finally, the Board believes the proposed rule should provide for more equitable treatment of all providers of check collection services by both reducing significantly the differences in the presentment abilities of private-sector collecting banks and Federal Reserve Banks, and providing for more balanced bargaining powers between paying banks and presenting banks.

Effect on Level of Intermediation

The proposed same-day settlement rule, if adopted, may have a direct effect on the amount of intermediation in the check collection system. The proposed rule would reduce significantly the differences in the presentment abilities between private-sector collecting banks and Federal Reserve Banks. As a result, collecting banks may reduce their reliance on intermediary banks in the check collection process to the extent that intermediary banks had been used to present checks to paying banks on terms better than those available to other collecting banks. The decision by collecting banks to use intermediary banks in a same-day settlement environment may be based to a greater extent on the efficiencies derived from the economies of scale the intermediary bank brings to the check collection process and not on the terms of presentment to the paying bank that the intermediary bank can provide. The shift from indirect presentment channels to direct presentment may affect Federal Reserve check collection volume to a greater extent than the volume of correspondent banks, due to the Reserve Bank's current greater presentment abilities.

Assuming equal availability, banks that currently deposit fine-sorted checks with the Federal Reserve may choose direct presentment if the sum of their incremental transportation, adjustment, and settlement costs (as well as the incremental processing costs, if processing must be moved to a peak time in order to meet the 8 a.m. presentment deadline) are less than the Federal Reserve Bank's fine-sort fees. Similarly, banks that deposit checks under the Federal Reserve's High Dollar Group Sort program may shift to direct presentment of those checks if the sum of their incremental processing, transportation, adjustment, and settlement costs are less than the Federal Reserve's High Dollar Group Sort fees. Similar analyses can be made with respect to shifts of other Federal Reserve check collection volume and

[13] Payor bank services generally consist of the provision of check information to the paying bank in an automated form. The information may consist of the MICR-line information on the checks being presented or the total value of checks being presented that are drawn on specified customer accounts.

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correspondent bank collection volume to direct presentment.

In a same-day settlement environment, a reduced reliance on intermediary banks is more likely to occur where a collecting bank has a large volume of checks drawn on a given paying bank. In these cases, banks may determine that direct presentment of certain checks is a more cost effective means of collection than use of an intermediary collecting bank. A reduction in intermediation is also more likely to occur with respect to the collection of checks drawn on large paying banks that currently impose large presentment fees or refuse presentment by private-sector collecting banks altogether.

In general, shifts away from intermediation channels may occur to a lesser extent with respect to those checks presented to remote, low-volume endpoints. In many cases, the Federal Reserve Bank is the only bank that currently presents to remote endpoints, and possibly would be the only bank that presents checks to these endpoints in a same-day settlement environment. The proportion of total Federal Reserve check collection volume consisting of checks drawn on remote, low-volume endpoints may increase if private-sector collecting banks determine that it is not cost-effective to present directly to these endpoints in a same-day settlement environment.

Although the reduction in intermediation may have a relatively greater impact on Federal Reserve check collection volume, correspondent banks may also be affected by the reduced need for intermediation in the check collection system. Today, a correspondent bank may provide check collection services to banks for checks drawn on paying banks with which it has established direct presentment arrangements and to non-clearinghouse participants for checks drawn on participants in the clearinghouse in which the intermediary bank is a member. Same-day settlement may reduce the value added by a correspondent bank in providing a "window" to these paying banks.

The Board believes that a same-day settlement rule would result in more balanced bargaining powers between paying banks and presenting banks, which may provide greater impetus for agreements between paying banks and presenting banks permitting presentment later than 8 a.m. under certain conditions. For example, a paying bank may agree to accept presentment of checks later in the day if the presenting bank transmitted the MICR-line data from the checks by some specified time in the morning. Therefore, the effects of the implementation of a same-day settlement rule may be more pronounced than would be evident from the terms of the rule itself to the extent that private-sector presenting banks obtain presentment abilities by agreement that are greater than those provided in the rule.

The Board requests comment on the anticipated effects of the proposed same-day settlement rule on the level of intermediation in the check collection system.

Effects on Check Collection Costs

A private-sector collecting bank's check collection costs would decrease in a same-day settlement environment to the extent that (1) certain costs related to direct presentment that the bank currently incurs (such as presentment fees and costs associated with balance requirements) are eliminated; (2) the costs to present checks directly to a paying bank are less than the costs currently incurred to collect the checks through an intermediary collecting bank; and (3) the costs assessed by an intermediary collecting bank for those checks that the collecting bank chooses not to present directly are lower than they are today.

These cost reductions might be offset to the extent that the cost to collect other checks through an intermediary collecting bank were to increase. Increased intermediary bank check collection fees could occur because (1) the intermediary bank's fixed costs may be spread over lower check collection volume due to the reduction in the level of intermediation in a same-day settlement environment; and/or (2) the intermediary bank's fees are set to be competitive with those of other intermediary collecting banks that have increased their fees to recover the costs of providing check collection services in a declining market.

The Board requests comment on the anticipated effects of the proposed same-day settlement rule on collecting banks' check collection costs.

Effect on prices and Market Share of Intermediary Collecting Banks

A decline in total Federal Reserve check volume could result in an overall increase in fees assessed by the Reserve Banks for check collection services, as the Federal Reserve's fixed costs (such as transportation costs) would be spread over fewer checks. At the same time, the costs currently incurred by correspondent banks related to presentment fees and balance requirements could be eliminated, which may enable them to reduce check collection fees. Moreover, as noted above, correspondent banks may be able to reduce further their check collection fees to the extent that they present checks directly to a paying bank at a cost lower than their current costs to collect those checks through another correspondent bank or a Federal Reserve Bank.

To the extent that Federal Reserve check collection fees increase relative to correspondent bank fees, correspondent banks may handle a larger proportion of checks that continue to be collected through intermediary collecting banks than they do today. It is very difficult, however, to predict the net effects of the proposed rule on correspondent bank check collection volume, because the increased volume they could gain due to their decreased check collection costs may be offset to some extent by the reduction in volume they could experience due to the elimination of their competitive advantage vis-a-vis other private-sector collecting banks in their terms of presentment to some paying banks.

The pricing policies of the Federal Reserve differ significantly from the pricing policies of correspondent banks. The Federal Reserve Banks must fully recover, in the long term, their costs of providing check collection services (including imputed costs that would have been incurred by a private firm), as required by the pricing principles established by the Board pursuant to the Monetary Control Act. Consequently, the Federal Reserve prices based on average cost, rather than marginal cost. Correspondent banks generally employ market-sensitive pricing and often do not attempt to recover the costs of their check collection service from the fees assessed for that service but rather charge fees to profit from their overall business relationship.

The Board believes that a same-day settlement rule will promote refinements to pricing strategies to reflect more clearly the economic costs of providing specific types of check collection services. In the case of Federal Reserve Banks, for example, tiered pricing of check collection services could become more important; like correspondent banks, the Federal Reserve Banks' fees may need to be tied more closely to the

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costs of the specific services they provide. Today, Federal Reserve check collection prices generally are based on the availability zone (i.e., city, RCPC, country) of the paying bank. The costs of collecting checks within a given availability zone may vary significantly. Tiered pricing may better reflect the cost of collecting checks on different endpoints, thus lessening the extent to which fees for collecting checks drawn on low-cost endpoints in an availability zone subsidize fees for collecting checks drawn on high-cost endpoints in that zone. Such a reduction in subsidization could stem volume declines that otherwise may have occurred.

The impact of a same-day settlement rule on correspondent bank pricing is less clear. Lower check collection costs incurred by correspondent banks together with potentially greater competition in the check collection market may exert downward pressure on correspondent bank check collection prices. However, to the extent that in some markets the Federal Reserve Bank is the only viable competitor to a correspondent bank in the provision of check collection services, an increase in Federal Reserve prices may allow some correspondent banks to increase prices and still remain competitive. The Board requests comment on the anticipated effects of a same-day settlement rule on check collection costs and the fees assessed by intermediary collecting banks.

Impact on Clearinghouses

Same-day settlement potentially could affect the size of and requirements for clearinghouse membership. The same-day settlement rule could prompt banks to reassess the value of clearinghouse membership. Clearinghouses currently provide three main benefits to their participants: (1) The ability to receive same-day settlement without the imposition of presentment fees for checks they exchange by the exchange times established by the clearinghouse rules; (2) decreased transportation costs for direct presentments through the exchange of checks at a common location; and (3) some adjustment and return services.

The benefits of clearinghouse participation may be diminished by same-day settlement to the extent that participants can obtain same-day settlement outside a clearinghouse arrangement by presenting checks by 8 a.m. Clearinghouse participants may weigh the costs of continued involvement in a clearinghouse (e.g., membership fees) against the incremental transportation and settlement costs of direct presentments outside the clearinghouse. If the incremental transportation and settlement costs of direct presentments outside the clearinghouse are lower than the costs of clearinghouse participation, banks may choose to limit their participation in or no longer belong to the clearinghouse.

The proposed rule also could prompt clearinghouses to reevaluate current membership requirements. Many clearinghouses currently restrict membership eligibility. For example, a number of clearinghouses are limited to commercial bank participants, and preclude thrift membership. Same-day settlement may encourage the relaxation of clearinghouse membership restrictions, because participants may find it more convenient to accept direct presentment from institutions currently prohibited from membership via the clearinghouse exchange to accept direct presentments at an alternate location, subject to separate settlement arrangements.

The Board requests comment on the effects of the proposed same-day settlement rule on clearinghouses. Specifically, the Board requests commenters to address the impact of the rule on the requirements for and membership levels of clearinghouses.

Impact on Paying Banks

The proposed same-day settlement rule could affect the costs and revenue of paying banks. Under same-day settlement, a paying bank may have a larger number of banks presenting checks to it than it does currently. Today, many paying banks receive presentments only from the Federal Reserve (and through a clearinghouse, if they are participants). Other paying banks also currently accept presentments from multiple private-sector presenting banks, on which they may assess presentment fees and impose balance requirements. Same-day settlement may prompt additional collecting banks to directly present checks to a paying bank. The number of additional presentments may vary based on (1) the volume of checks payable by or through the paying bank; (2) the location of the paying bank; and (3) the extent to which the paying bank currently uses presentment fees or other barriers to direct presentment.

An increase in presentments could increase the complexity of the paying bank's check operations and result in an increase in costs. The paying bank could have to open more packages (to the extent that the direct presentments do not represent a replacement of fine-sort deposit volume), reconcile more entries, settle with more presenting banks and deal with more parties in resolving adjustments. In addition, paying banks that accept direct presentments today may lose presentment fee income and correspondent balances they receive today.

The potential changes in check collection practices resulting from the proposed same-day settlement rule may affect the provision of payor bank services. A paying bank that currently receives presentments primarily from the Federal Reserve and obtains payor bank services with respect to those presentments may begin to receive presentments from other banks. If the payor bank services are viewed as important by the paying bank, it may seek payor bank services from the presenting bank, and agree to compensate the presenting bank either through fees or by accepting later-in-the-day presentments, if the payor bank services are received by a specified time. Alternately, the paying bank may choose to designate as its alternate presentment point a bank or data processor that has the ability to provide payor bank services.

If the paying bank receives a large number of direct presentments and is unable to obtain payor bank services at a cost-effective price for those checks collected outside the Federal Reserve, the value of the payor bank services it receives from checks collected through the Federal Reserve could diminish, because the information would relate to a smaller proportion of the bank's total presentment. This may have an adverse effect on the paying bank's operations (e.g., if the paying bank uses the payor bank services to post to its customers' accounts) and on the quality of cash management information the paying bank may be able to provide to its corporate customers if the paying bank does not have the capacity to process checks presented by private-sector presenting banks on a timely basis. To maintain or improve its level of customer service, paying banks may encourage its customers to use electronic payments, which would provide greater certainty regarding the timing of payments.

The Board requests comment on the impact of the same-day settlement rule on paying banks.

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Impact on Bank Customers

The impact of the same-day settlement rule on bank customers will depend on the role of the customers, the role of the customer's bank in the marketplace, and the competitiveness of the marketplace. Bank customers, in their role as depositors of checks, would generally be unaffected by the same-day settlement rule. Depositors may benefit from lower account service charges or delayed increases in service charges, if the depositary bank experiences some savings in its check collection costs. Customer availability of funds may also improve at the margin, to the extent that the depositary bank experiences availability gains due to the rule and passes this improved availability to its customers. The benefits may be greater for those depositors with accounts in banks in competitive markets for check collection services because a competitive market may enable the customer's bank to choose lower cost collection alternatives. In markets with less competition, customers may experience little or no cost savings, or even slight cost increases if bank's check collection costs increase (see discussion of effects on intermediary collecting bank prices).

Retail bank customers, in their role as drawers of checks, generally would be unaffected by a same-day settlement rule. Since same-day settlement is not likely to result in significant improvements in availability, checks generally would not be posted to the drawer's account on an earlier day than is the case today. To the extent that some checks are collected one day faster than is the case today, checks would be posted to retail customer accounts earlier; however, the Board believes that this may not affect customer behavior. To the extent that the paying bank is funding the costs of providing checking services to its customers through the presentment fee and correspondent balance income it receives, customer service fees may increase somewhat to offset the loss of the revenue.

The primary objections of the commenters on the Board's initial same-day settlement proposal related to the proposal's anticipated adverse impact on corporate cash management services. Many corporations require early-in-the-day information on the value of checks presented against their accounts so they can participate in financial markets early in the day to either invest excess funds or purchase funds necessary to cover their presentment. The commenters were concerned that the initially proposed 2 p.m. presentment deadline would restrict and possibly eliminate corporate cash management and controlled disbursement services. The Board believes that an 8 a.m. presentment deadline would minimize these concerns. However, at the margin, corporate disbursers may find that account information that they rely upon for investment or funding decisions may become less reliable to the extent the bank is unable either to process checks presented at the 9 a.m. deadline in time to obtain the necessary information or is unable to obtain adequate payor bank services. If the cash management information can be made available, the corporate customer may experience some cost increases as paying banks find it more expensive to meet these information needs.

Corporate disbursement customers would not experience significant amounts of interday float loss due to same-day settlement as checks destined to most high-volume, high-dollar endpoints are collected overnight today.

The Board requests comment on the impact of the same-day settlement rule on bank customers.

Effects on the Migration to Electronic Payments

The proposed same-day settlement rule may encourage banks to convert checks to electronic payments. Presenting banks, pursuant to agreements with paying banks, may begin to send electronic payment information to the paying bank in conjunction with the physical presentment. After the paying bank becomes comfortable receiving electronic check information from multiple sources, the bank may encourage customers to allow checks to be paid based on receipt of the electronic presentment rather than the physical checks, allowing the physical checks to be converted to electronic payments (i.e., check truncation).

If some corporations cannot receive complete information regarding the total value of checks presented against their account early enough in the day to make investment decisions, they may decide to replace the check payments with electronic payments. Generally, electronic payments may provide earlier-in-the-day receipt of information regarding payments due to settle on a given day in a cost-effective manner. The Board requests comment on the extent to which a same-day settlement rule may spur or deter the migration of check payments to electronic payments.

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.[14] Under these procedures, the Board will assess whether the proposed change would have a direct and material adverse effect on the 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 Board believes that the proposed same-day settlement rule would likely enhance the ability of correspondent banks and other service providers to compete with the check collection services offered by Federal Reserve Banks. The proposed rule would improve collecting banks' current presentment abilities by providing explicitly that paying banks must settle for checks presented by private-sector presenting banks on the day of presentment in final funds. As discussed in the economic impact analysis, these improved presentment rights generally should enhance the competitive environment between the Federal Reserve Banks and private-sector collecting banks.

A presentment deadline of 2 p.m. for same-day settlement would provide a greater equivalence of presentment abilities between the Federal Reserve Banks and private-sector banks than would the proposed 8 a.m. deadline. As discussed above, the Board had previously issued for public comment a same-day settlement concept that would have provided private-sector banks presentment abilities generally equal to those of Federal Reserve Banks. The overwhelming majority of commenters expressed concern regarding the effects of a 2 p.m. presentment deadline on the provision of corporate cash management services and on paying bank operations. In light of these concerns, the proposed 8 a.m. presentment deadline appears to be appropriate at this time because it would likely allow substantially greater direct presentment of checks by private-sector collecting banks and at the same

[14] These procedures are described in the Board's policy statement "The Federal Reserve in the Payments System," which was revised in March 1990. (55 FR 11648, March 29, 1990)

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time would moderate the potential operational difficulties an afternoon deadline may create for paying banks.

Similarly, an 8 a.m. presentment deadline that would be applicable to both Federal Reserve Banks and private-sector presenting banks would provide greater equivalence of presentment abilities than would the proposal. Requiring the Federal Reserve Banks to meet an earlier-in-the-day presentment deadline, however, would slow the collection of checks handled by the Federal Reserve, and thus would be contrary to the objective of the Expedited Funds Availability Act to speed the check collection process.

The Board will rely on information provided by the commenters to conduct a more detailed analysis of the competitive impact of the proposal in considering its final action on the rule.

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. Two of the requirements of an initial regulatory flexibility analysis (5 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 recordkeeping requirements.

The Regulatory Flexibility Act also requires identification of other relevant federal rules that duplicate, overlap, or conflict with the proposed rule. While the proposed same-day settlement rule would be part of Regulation CC, which applies to Federal Reserve Banks as well as private-sector banks, Federal Reserve Banks will continue to avail themselves of the greater presentment abilities authorized by Regulation J, as explained in the supplementary material above. Therefore, there is no conflict of federal rules.

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 proposal will apply to all banks regardless of size, but should not place a significant burden on small banks. Some small banks have argued that, as a result of the proposal, more banks will present directly for same-day settlement and check volume will shift from the Federal Reserve to the private sector, causing an increase in the Federal Reserve's check collection fees. The small banks may argue that correspondent bank fees will also rise because, historically, the Federal Reserve's fees have been the ceiling for check collection fees. The small banks, many of whom collect through the Federal Reserve due to their reluctance to collect checks through their competitors, see the long-term effects of the rule as benefiting primarily larger banks that present directly.

The Board believes that the concerns of the small banks would not be ameliorated by excluding them from the proposed regulation. The issues raised by small banks are related to the secondary effects of the proposal, and the volume shifts that may take place would be attributable primarily to the applicability of the same-day settlement rule to large paying banks. In addition, because the primary purpose of the proposal is to increase the efficiency of the check forward collection process, to exclude small banks from the requirement of making same-day settlement would be counter to the chief objective of the proposal. The Board believes that any burden on small banks would be outweighed by the improvements in the payments system under a rule that applies to all checks and all banks.

List of Subject in 12 CFR Part 229

Banks, banking, Federal Reserve System, Reporting and recordkeeping requirements.

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. 552, 635, 12 U.S.C. 4001 *et seq.*

2. In § 229.2, paragraph (mm) is redesignated as paragraph (oo) and new paragraphs (mm) and (nn) are added to read as follows:

§ 229.2 Definitions.

* * * * *

(mm) *Good faith* means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(nn) *Interest compensation* means an amount of money calculated at the average of the Federal Funds rates published by the Federal Reserve Bank of New York for each of the days for which interest compensation is payable, divided by 360. The Federal Funds rate for any day on which a published rate is not available is the same as the published rate for the immediately preceding day for which there is a published rate.

* * * * *

3. In § 229.30, paragraph (c) introductory text is revised to read as follows:

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

* * * * *

(c) *Extension of deadline.* The deadline for return or notice of nonpayment under the UCC, Regulation J (12 CFR part 210), or § 229.36(f)(2) of this part is extended—

* * * * *

4. In § 229.34, the heading is revised, paragraphs (c) and (d) are redesignated as paragraphs (d) and (e), respectively, a new paragraph (c) is added, and newly redesignated paragraph (d) is revised to read as follows:

§ 229.34 Warranties by paying bank, presenting bank, and returning bank.

* * * * *

(c) *Warranty of settlement amount.* Each bank that presents a check or checks to a paying bank and receives settlement for the check or checks warrants that the total amount of the checks presented as encoded in magnetic ink on the checks is equal to the total amount of the settlement demanded by the presenting bank from the paying bank.

(d) *Damages.* Damages for breach of these warranties shall not exceed the consideration received by the paying bank, presenting bank, or returning bank, plus interest compensation and expenses related to the check or returned check, if any.

* * * * *

5. In § 229.36, a new paragraph (f) is added to read as follows:

§ 229.36 Presentment and issuance of checks.

* * * * *

(f) *Same-day settlement.*

(1) A paying bank must settle for a check pursuant to paragraph (f)(2) of this section if the check is presented for payment by a bank (other than for immediate payment over the counter)—

(i) At a location of the paying bank designated by the paying bank that is in the check processing region consistent with the routing number designated in magnetic ink on the check or, if no location is designated, at any location

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described in paragraph (b) of this section; and

(ii) By 8 a.m. (local time of the location described in paragraph (f)(1)(i) of this section).

(2) If presentment of a check meets the requirements of paragraph (f)(1) of this section, the paying bank becomes accountable for the amount of the check unless, by the close of Fedwire on the business day on which it receives the check, it either:

(i) Settles with the presenting bank for the amount of the check by credit to an account at a Federal Reserve Bank designated by the paying bank; or

(ii) Returns the check.

A paying bank may require that checks presented for settlement under this paragraph be separated from other forward-collection checks or returned checks. If a paying bank closes voluntarily on a business day and a presenting bank presents or delivers a check to the paying bank on that day in accordance with paragraph (f)(1) of this section, the paying bank becomes accountable for the amount of the check unless it either settles for the check in accordance with paragraph (f)(2) of this section on the day of presentment or settles for the check in accordance with paragraph (f)(2) of this section on its next banking day. If the paying bank does not settle for the check on the day of presentment, it shall pay interest compensation to the presenting bank for each day after the presenting bank presents or delivers the check to the paying bank until the paying bank settles for the check, including the day of settlement.

6. In § 229.39, a new paragraph (e) is added to read as follows:

§ 229.39 Insolvency of bank.

* * * * *

(e) *Preference against presenting bank.* If a paying bank settles with a presenting bank for a check or checks, and if the amount of the settlement is in excess of the total value of checks presented, and the presenting bank suspends payments before reimbursing the paying bank for the difference between the settlement amount and the total value of the checks presented, the paying bank has a preferred claim against the presenting bank for the difference between the settlement amount and the total value of the checks presented.

Appendix E—[Amended]

7. Appendix E is amended as set forth below:

a. The Commentary to § 229.2 is amended by reserving paragraph (mm) and adding a new paragraph (nn) to read as follows:

Section 229.2 Definitions

* * * * *

(mm) [Reserved]

(nn) *Interest Compensation.* This calculation of interest compensation derives from UCC section 4A–506(b). (See § § 229.34(d) and 229.36(f).)

b. The Commentary to § 229.30(c) is amended by revising the introductory text, the first two sentences in numbered paragraph (1), the second sentence in numbered paragraph (2), the first sentence of the paragraph immediately following numbered paragraph (2), and the last two paragraphs to read as follows:

Section 229.30 Paying Bank's Responsibility for Return of Checks

* * * * *

(c) *Extension of deadline.* This paragraph permits extension of the deadlines for returning a check for which the paying bank has previously settled (generally midnight of the banking day following the banking day on which the check is received by the paying bank) and for returning a check without settling for it (generally midnight of the banking day on which the check is received by the paying bank, or such other time provided by 12 CFR 210.9 of Regulation J or § 229.36(f)(2)), but not of the duty of expeditious return, in two circumstances:

1. A paying bank may have a courier that leaves after midnight (or after any other applicable deadline) to deliver its forward-collection checks. This paragraph removes the constraint of the deadline for returned checks reached either the depository bank or the returning bank to which it is sent on that bank's banking day following the expiration of the applicable deadline. * * *

2. * * * In such a case, the UCC deadline for returning checks received and settled for on Friday, or for returning checks received on Saturday without settling for them, might require the bank to return the checks by midnight Saturday. * * *

The time limits that are extended in each case are the paying bank's midnight deadline for returning a check for which it has already settled and the paying bank's deadline for returning a check without settling for it in UCC sections 4–301 and 4–302, 12 CFR 210.9 and 210.12 of Regulation J, and § 229.36(f)(2). * * *

The paying bank satisfies its midnight or other return deadline by dispatching returned checks to another bank by courier, including a courier under contract with the paying bank, prior to expiration of the deadline.

This paragraph directly affects UCC sections 4–301 and 4–302, § § 210.9 and 210.12 of Regulation J (12 CFR 210.9 and 210.12), and § 229.36(f)(2) to the extent that this paragraph applies by its terms, and may affect other provisions.

c. The Commentary to § 229.34 is amended by revising the heading, redesignating paragraphs (c) and (d) as paragraphs (d) and (e), respectively, adding a new paragraph (c), and revising newly redesignated paragraph (d) to read as follows:

Section 229.34 Warranties by Paying Bank, Presenting Bank, and Returning Bank

* * * * *

(c) *Warranty of settlement amount.* This paragraph provides that the presenting bank warrants to the paying bank that the total of the checks presented, as demanded by the presenting bank (e.g., as noted on the cash letter), equals the total value of the checks presented as encoded in magnetic ink on the MICR lines of the checks. (Warranties on the accuracy of MICR encoding are contained in UCC section 4–209.) This paragraph creates a warranty claim on a presenting bank for the amount of any excess settlement made on the basis of the amount stated in the presenting bank's cash letter, plus expenses. For cash letters where the amount demanded is understated, the paying bank discharges its settlement obligation under section 4–301 of the UCC by paying the amount demanded in the cash letter, but remains liable for the amount by which the demand is understated. If the amount demanded is understated, the presenting bank is nevertheless liable for expenses in resolving the adjustment.

(d) *Damages.* This paragraph adopts for the new warranties in § 229.34 (a), (b), and (c) the damages provided in UCC sections 4–207(c) and 4A–506(b). (See definition of "interest compensation" in § 229.2(nn).)

* * * * *

d. The Commentary to § 229.36 is amended by adding a new paragraph (f) to read as follows:

Section 229.36 Presentment and Issuance of Checks

* * * * *

(f) *Same-day settlement.*

This paragraph provides that, under certain conditions, a paying bank must settle with a presenting bank for a check on the same day it receives the check for presentment in order to avail itself of the ability to return the check on its next banking day under sections 4–301 and 4–302 of the UCC. This paragraph does not apply to checks presented for immediate payment over the counter. Settling for a check under this paragraph does not constitute final payment of the check under the UCC. This paragraph does not supersede or limit the rules governing collection and return on checks through Federal Reserve Banks that are contained in subpart A of Regulation J (12 CFR part 210).

To qualify for mandatory same-day settlement, a check must be presented at a location of the paying bank designated by the paying bank for same-day settlement checks by 8 a.m. local time of that location. The designated presentment location must be within the check processing region consistent with the routing number printed in the MICR line of the check. A paying bank that uses

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more than one routing number associated with a single check processing region may designate one or more locations in that check processing region at which checks will be accepted for same-day settlement, but the paying bank must accept any checks with a routing number associated with that check processing region at each designated location.

If the paying bank does not designate a presentment location, it must accept presentment for same-day settlement at any location identified in § 229.36(b), i.e., at an address of the bank associated with the routing number of the check, at any branch or head office if the bank is identified on the check by name without address, or 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. A paying bank and a presenting bank may agree that checks will be accepted for same-day settlement at an alternative location (e.g., at an intercept processor) or that the cut-off time for same-day settlement be earlier or later than 8 a.m. local time.

In the case of a check payable through a bank but payable by another bank, this paragraph does not authorize direct presentment to the bank by which the check is payable. The requirements of same-day settlement under this paragraph would apply to the payable-through bank to which the check is sent for payment or collection.

Both presenting banks and paying banks will be held to a standard of good faith, as defined in § 229.2(mm). For example, designating a presentment location for the primary purpose of discouraging banks from presenting checks for same-day settlement might not be considered good faith on the part of the paying bank. Similarly, presenting a large volume of checks without prior notice could be viewed as not meeting reasonable commercial standards of fair dealing and therefore may not constitute presentment in good faith.

If a bank presents a check in accordance with the time and location requirements for presentment under this paragraph, the paying bank either must settle for the check on the business day it receives the check without charging a presentment fee or must return the check prior to the time for settlement. (This return deadline is subject to extension under § 229.30(c).) The settlement must be in the form of a credit to an account designated by the presenting bank at a Federal Reserve Bank (e.g., a Fedwire transfer). The presenting bank may agree to accept settlement in another form to which the presenting bank agrees (e.g., credit to an account of the presenting bank at the paying bank or debit to an account of the paying bank at the presenting bank). The settlement must occur by the close of Fedwire on the business day the check is received by the paying bank. Under the common law right of set-off, generally a settlement owed to a presenting bank may be set off by adjustments for previous settlements with the presenting bank. (See also §§ 229.34(c) and 229.39(e).)

A paying bank may require that checks presented to it for same-day settlement be separately sorted from other forward-collection checks it receives as a collecting bank or paying bank or returned checks it receives as a returning bank or depositary bank. If a bank that provides check collection services to another bank receives unsorted checks from that bank that include checks for which it is the paying bank and that would otherwise meet the requirements for same-day settlement under this section, the collecting bank receiving the unsorted checks may charge a fee for handling those checks and need not make settlement in accordance with this paragraph. In the case of sorted checks received by that collecting bank from another bank containing only checks for which that collecting bank is the paying bank and which meet the requirements for same-day settlement under this paragraph, that collecting bank may not charge a fee for handling those checks and must make settlement in accordance with this paragraph.

There may be certain business days that are not banking days for the paying bank. Some paying banks may continue to accept presentment of checks on such days (e.g., by opening their back office operations or by accepting presentment at a night depository or at any intercept processor) and to settle for the checks. In other cases, a paying bank may be unable to accept presentment of checks on such a day, or may be able to accept presentment but not settle for the checks. In these cases, if the paying bank has closed voluntarily on that day and checks are presented or delivered to the paying bank as required by paragraph (f)(1) of this section, the paying bank must settle for the checks by its next banking day and must pay interest compensation, as defined in § 229.2(nn), to the presenting bank for the value of the float associated with the check.

e. The Commentary to § 229.38 is amended by revising the last sentence of the first paragraph of paragraph (a) as follows:

Section 229.38 Liability

(a) *Standard of care; liability; measure of damages.*

* * * The standard of care is similar to the standard imposed by UCC sections 1–203 and 4–103(a) and includes a duty to act in good faith, as defined in § 229.2(mm) of this regulation.

* * * * *

f. The Commentary to § 229.39 is amended by adding a new paragraph (e) as follows:

Section 229.39 Insolvency of Bank

* * * * *

(e) *Preference against presenting bank.* This paragraph gives a paying bank a preferred claim against a closed presenting bank in the event that the presenting bank does not reimburse the paying bank for adjustments for a settlement made by the paying bank in excess of the value of the checks presented.

By order of the Board of Governors of the Federal Reserve System, January 30, 1991.

William W. Wiles,

Secretary of the Board.

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