

FEDERAL RESERVE SYSTEM**12 CFR Part 229****[Regulation CC; Docket No. R-1409]****RIN 7100-AD68****Availability of Funds and Collection of Checks****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Final rule.

SUMMARY: The Board is amending subparts A, C, and D of Regulation CC, Availability of Funds and Collection of Checks, which implements the Expedited Funds Availability Act of 1987 (EFA Act), the Check Clearing for the 21st Century Act of 2003 (Check 21 Act), and the official staff commentary to the regulation. In the final rule, the Board has modified the current check collection and return requirements to reflect the virtually all-electronic check collection and return environment and to encourage all depository banks to receive, and paying banks to send, returned checks electronically. The Board has retained, without change, the current same-day settlement rule for paper checks. The Board is also applying Regulation CC's existing check warranties under subpart C to checks that are collected electronically, and in addition, has adopted new warranties and indemnities related to checks collected and returned electronically and to electronically-created items.

DATES: Effective July 1, 2018.

FOR FURTHER INFORMATION CONTACT: Clinton N. Chen, Attorney (202-452-3952), Legal Division; or Ian C.B. Spear, Senior Financial Services Analyst (202-452-3959), Division of Reserve Bank Operations and Payment Systems; for users of Telecommunication Devices for the Deaf (TDD) only, contact 202-263-4869; Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551.

SUPPLEMENTARY INFORMATION:**I. Statutory and Regulatory Background**

Congress enacted the EFA Act¹ to provide depositors of checks with prompt funds availability and to foster improvements in the check collection and return processes. Section 609(b) directs the Board to consider requiring depository institutions and Federal Reserve Banks to take certain steps to improve the check-processing system, such as automating the check-return

process.² Section 609(c) authorizes the Board to regulate any aspect of the payment system and any related function of the payment system with respect to checks in order to carry out the provisions of the EFA Act.³

The Board implemented the EFA Act in subparts A, B, and C of Regulation CC. Subpart A of Regulation CC contains general information, such as definitions of terms. Subpart B of Regulation CC specifies availability schedules within which banks must make funds available for withdrawal and includes rules regarding exceptions to the schedules, disclosure of funds availability policies, and payment of interest.⁴ Subpart C of Regulation CC implements the EFA Act's provisions regarding forward collection and return of checks.

The current provisions of subpart C presume that banks generally handle checks in paper form and include provisions to speed the collection and return of checks, such as the expeditious return requirements for paying and returning banks, authorization to send returns directly to depository banks, notification of nonpayment of large-dollar returned checks, standards for check indorsement, and specifications for same-day settlement of checks presented to the paying bank.

The Check 21 Act, which became effective in October 2004, facilitated electronic collection and return of checks by permitting banks to create a

paper "substitute check" from an electronic image and electronic information derived from a paper check. The Check 21 Act authorized banks to provide substitute checks to a bank or a customer that had not agreed to electronic exchange. The Board implemented the Check 21 Act primarily in subpart D of Regulation CC.⁵

II. Summary of the Current, Proposed, and Final Rule

On February 4, 2014, the Board published a notice of proposed rulemaking ("proposal") intended to facilitate the banking industry's ongoing transition to fully-electronic interbank check collection and return.⁶ The Board requested comment on amendments to subparts A, C, and D of Regulation CC.⁷ The Board received 40 responses to its proposal from a variety of commenters, including financial institutions, trade associations, clearinghouses, private individuals, and academia. The Board has considered all comments received and has adopted amendments to Regulation CC as described below.⁸

A. Return Requirements

Regulation CC requires a paying bank that determines not to pay a check to return the check expeditiously.⁹ Under

⁵ Section 15 of the Check 21 Act states that the Board may prescribe such regulations as the Board determines to be necessary to implement, prevent circumvention or evasion of, or facilitate compliance with the provisions of this Act. 12 U.S.C. 5014.

⁶ The Board originally proposed amendments in 2011 ("2011 proposal"). 76 FR 16862 (March 25, 2011). Based on its analysis of the comments received on the 2011 proposal, the Board revised its proposed amendments and requested comment in the proposal in 2014. 79 FR 6674 (Feb. 4, 2014).

⁷ The Board is not amending subpart B of Regulation CC at this time. Section 1086 of the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the EFA Act to make the Board's authority for the EFA Act's provisions implemented in subpart B joint with the Consumer Financial Protection Bureau.

⁸ After publication of the Board's proposal, the OCC, Board, and the FDIC began a review of regulations to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). The Board has also considered comments related to subparts A, C, and D of Regulation CC received as part of the EGRPRA process.

⁹ When Congress enacted the EFA Act in 1987, the time required for delivery of returned paper checks to the depository bank was often longer than the maximum hold periods to which the banks would be subject under the EFA Act. Many paying banks did not have dedicated transportation infrastructure to return paper checks and would typically send the returned check by mail, which could significantly slow the return process. 52 FR 47112, 47118 (Dec. 11, 1987). To speed the return of checks and to reduce the risk that depository banks would make funds from a check available before learning of the check's nonpayment, the

¹ Expedited Funds Availability Act, 12 U.S.C. 4001 *et seq.*; Check Clearing for the 21st Century Act, 12 U.S.C. 5001 *et seq.*

² EFA Act section 609(b)(4) states that in order to improve the check processing system, the Board shall consider (among other proposals) requiring, by regulation, that the Federal Reserve banks and depository institutions take such actions as are necessary to automate the process of returning unpaid checks. 12 U.S.C. 4008(b)(4).

³ EFA Act section 609(c)(1) states that in order to carry out the provisions of this title, the Board of Governors of the Federal Reserve System shall have the responsibility to regulate 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. 12 U.S.C. 4008(c)(1). EFA Act section 609(c)(2) states that the Board shall prescribe such regulations as it may determine to be appropriate to carry out its responsibility. 12 U.S.C. 4008(c)(2). EFA Act section 611(f) authorizes the Board to impose on or allocate among depository institutions the risks of loss and liability in connection with 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. Such liability shall not exceed the amount of the check giving rise to the loss or liability, and, where there is bad faith, other damages, if any, suffered as a proximate consequence of any act or omission giving rise to the loss or liability. 12 U.S.C. 4010(f).

⁴ The term "bank" as used in this notice and in Regulation CC (12 CFR 229.2(e)) includes a commercial bank, savings bank, savings and loan association, credit union, and a U.S. agency or branch of a foreign bank.

the current expeditious return provisions of Regulation CC, a paying bank must return the check as provided under either the “two-day test” or the “forward-collection test.”¹⁰ Regulation CC permits a paying bank to send a returned check either directly to the depository bank or to any bank agreeing to handle the return expeditiously.¹¹ Regulation CC also currently requires a paying bank that determines not to pay a check in the amount of \$2,500 or more to provide a notice of nonpayment to the depository bank such that the notice is received by the depository bank within the same timeframe as under the “two-day test” for expeditious return.¹²

These return requirements were originally implemented when check collection and return was largely paper-based. Now, the interbank clearing process is almost entirely electronic: by the beginning of 2017 the Federal Reserve Banks received over 99.99 percent of checks electronically from 99.06 percent of routing numbers and presented over 99.99 percent of checks electronically to over 99.76 percent of routing numbers. This mostly electronic environment offers lower costs, faster returns, and fewer errors, which substantially reduces risk to the check system compared to the previous largely paper-based environment. A portion of check returns, however, are still conducted using paper: by the beginning of 2017 the Federal Reserve Banks received 99.63 percent of

returned checks electronically from over 99.37 percent of routing numbers and delivered 99.41 percent of returned checks electronically but to only 92.84 percent of routing numbers.

In an effort to identify incentives that would encourage the broadest possible implementation of electronic check return for those remaining institutions still using paper, the Board requested comment in its proposal on two alternative approaches to the requirements imposed on paying banks and returning banks. Under the first alternative (“Alternative 1”), the Board proposed to eliminate the expeditious return requirement for paying banks and returning banks.¹³ The Board also proposed under Alternative 1 to require the paying bank to provide the depository bank with a notice of nonpayment when the paying bank sends the returned check in paper form, but not when the paying bank sends the returned check in electronic form.¹⁴ The notice of nonpayment requirement would apply to all paper returned checks regardless of the amount of the check being returned, and the paying bank would be required to deliver the notice to the depository bank by 2 p.m. on the second business day following presentation of the check to the paying bank (two hours earlier than the current requirement).

Under the second alternative (“Alternative 2”), the Board proposed to eliminate the notice of nonpayment requirement and to preserve the expeditious return requirement with slight modification. Specifically, the Board proposed that paying banks would be subject to a modified expeditious return requirement (using the “two-day test”) if the paying bank

has an agreement to send returned checks electronically either directly to the depository bank or to a returning bank that is subject to the expeditious return requirement.¹⁵ Returning banks would be subject to requirements similar to those for paying banks under proposed Alternative 2.

Commenters were generally split as to whether the Board should adopt proposed Alternative 1, proposed Alternative 2, or neither of the proposed alternatives.¹⁶ Most commenters, however, expressed support for certain aspects of each proposed alternative. The Board has adopted a final rule that incorporates elements of both proposed Alternative 1 and Alternative 2.

In the final rule, the Board has required all returned checks, both paper and electronic, to satisfy a modified version of the “two-day test,” meaning that they must be returned in an expeditious manner, such that the check would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank. The Board also has added a new condition for expeditious-return liability, specifically that a paying bank and returning bank may be liable to a depository bank for failing to return a check in an expeditious manner only if the depository bank has arrangements in place such that the paying bank or returning bank could return a returned check electronically, directly or indirectly, by commercially reasonable

Board in Regulation CC exercised its authority under sections 609(b) and (c) the EFA Act to automate the return process and to establish the expeditious return requirement. 53 FR 19372, 19377 (May 27, 1988).

¹⁰ Under the two-day test, a paying bank must send a returned check such that the check would normally be received by the depository bank not later than 4 p.m. local time of the depository bank on the second business day following the banking day on which the check was presented to the paying bank. 12 CFR 229.30(a)(1)(i). Under the forward-collection test, a paying bank must send the returned check in a manner that a similarly situated bank would send a check (i) of similar amount as the returned check, (ii) drawn on the depository bank, and (iii) deposited for forward collection in the similarly situated bank by noon on the banking day following the banking day on which the check was presented to the paying bank. 12 CFR 229.30(a)(2).

For nonlocal checks, there is a four-day test under which a paying bank must send a returned check such that the check would normally be received by the depository bank not later than 4 p.m. local time of the depository bank on the fourth business day following the banking day on which the check was presented to the paying bank. 12 CFR 229.30(a)(1)(ii). Because there is now only one Federal Reserve Bank check processing region, there are no longer any nonlocal checks, and the four-day test applies to a null set of checks.

¹¹ 12 CFR 229.30(a).

¹² Return of the check itself satisfies the notice of nonpayment requirement if the return meets the timeframe requirement for a notice of nonpayment.

¹³ The Board believed that the approach in Alternative 1 would provide incentives to depository banks to accept electronic returns. Under this alternative, depository banks that do not currently accept electronic returns would have a greater incentive to do so because only by receiving returns electronically would they be likely to learn about nonpayment of a deposited check before making funds available to their customers. Alternative 1 was based on the Board’s belief that in today’s virtually all-electronic check-processing environment, a check returned electronically through the entire return path should be received by the depository bank within two business days of the check’s presentation to the paying bank without an expeditious return requirement, assuming returning banks do not change processing timeframes.

¹⁴ Retaining a notice of nonpayment requirement only for paper returned checks in Alternative 1 would have provided paying banks with an incentive to send returned checks electronically (in order to avoid having to comply with the notice of nonpayment requirement) and ensure that depository banks receive timely notice of returned checks (because they would generally receive either the electronic return or a notice of nonpayment within the two-day timeframe).

¹⁵ Under Alternative 2, depository banks that do not currently accept electronic returns would have a greater incentive to do so because they would not otherwise be entitled to expeditious return of unpaid checks and would therefore be at a greater risk of having to make funds available to their customers before learning that the deposited check was returned unpaid.

¹⁶ Commenters that preferred Alternative 1 emphasized that it had the least financial, technology, and potential liability impact on financial institutions. Commenters that opposed Alternative 1 stated that it did not provide sufficient incentives for depository institutions to accept electronic returns and could result in slower return of checks. Furthermore, these commenters noted that Alternative 1 placed an increased risk on depository banks that may receive electronic returns outside of the two-day window. Commenters that preferred Alternative 2 reasoned that it provided greater incentives than Alternative 1 for depository institutions to accept electronic returns. Commenters against Alternative 2 stated that it was difficult for a paying bank to know whether it had agreements in place that would allow it to send returned checks electronically indirectly to a particular depository bank. The commenters that preferred neither alternative stated that a significant number of smaller financial institutions still relied on paper returns and would incur costs to shift to electronic returns and generally have fewer resources to manage the increased risk and exposure from potentially slower paper returns.

means. The depository bank has the burden of proof for demonstrating that its arrangements for accepting returned checks electronically are commercially reasonable. The Board believes that this approach will provide incentives to depository banks to receive electronic returns so that they preserve their ability to make a claim that a check was not returned expeditiously.¹⁷ The final rule also provides that if a paying bank determines not to pay a check in the amount of \$5,000 or more (rather than the current \$2,500 threshold), it must provide a notice of nonpayment such that the notice would normally be received by the depository bank by 2 p.m. (rather than the current deadline of 4 p.m.) on the second business day following the banking day on which the check was presented to the paying bank.

B. Same-Day Settlement

Section 229.36(f) of Regulation CC currently requires a paying bank to provide same-day settlement for checks presented in accordance with reasonable delivery requirements established by the paying bank and presented at a location designated by the paying bank by 8 a.m. (local time of the paying bank) on a business day.¹⁸ A paying bank may not charge presentment fees for checks—for example, by settling for less than the full amount of the checks—that are presented in accordance with same-day settlement requirements.

In its proposal, the Board proposed to retain, without substantive change, Regulation CC's current same-day settlement rule because the Board believed that the terms of electronic presentment should be determined by agreement between banks. Most commenters agreed with Board's proposal, stating that the terms of electronic presentment are already

¹⁷ The Board believes that paying banks will have an incentive to send returns electronically because electronic returns are more likely to meet the requirements of the "two-day test" than paper returns. The Board also believes that there are only minimal risks of paying banks attempting to evade the expeditious return requirements (and avoid liability) by refusing to enter into agreements to send electronic returns. Most paying banks already have in place agreements to return checks electronically and use entirely electronic return processes. Smaller paying banks that may not have in place electronic return arrangements typically use the Federal Reserve Banks' check return service, which enables those banks to return checks indirectly to the depository bank electronically, thereby subjecting those paying banks or the Federal Reserve Banks to liability for failure to return a check expeditiously under the final rule.

¹⁸ The Board established the same-day settlement rule, which became effective in 1994, to reduce the competitive disparity between the Federal Reserve Banks and other presenting banks and to balance the bargaining power between presenting banks and paying banks more equitably.

effectively governed by agreements between banks such that an electronic same-day-settlement rule would be unnecessary or even burdensome. Some commenters also believed that the Board should eliminate the paper same-day-settlement rule entirely, as the original rationale for its implementation is no longer relevant given today's almost all-electronic check-presentment environment. Although the Board agrees that the terms of electronic presentment should be appropriately determined by agreement between banks, the Board believes that the existence of the paper same-day-settlement rule can be a valuable incentive for banks to negotiate electronic same-day settlement agreements. Consistent with the majority of comments received, the Board in its final rule retains the current same-day settlement rule, with only minor technical changes.¹⁹

C. Framework for Electronic Check Collection and Return

Regulation CC, subpart C currently applies only to paper checks. Thus, the provisions of subpart C related to acceptance of returned checks, presentment, and warranties do not apply to electronic images of checks ("electronic images") or to electronic information derived from checks ("electronic information").²⁰ Rather, the collection and return of electronic images and electronic information are governed by agreements between the banks. These agreements may be in the form of the Federal Reserve Banks' operating circular or a clearinghouse agreement.²¹ The agreements often include, among other terms, warranties for electronic checks similar to those made for substitute checks under the Check 21 Act ("Check-21-like warranties").²²

The Board proposed amendments to subpart C that would create a regulatory framework for the collection and return of electronic images and electronic information. The Board proposed to define the terms "electronic check" and "electronic returned check" as an

¹⁹ The Board proposed minor technical changes to reflect the existence of a single check processing region nationwide.

²⁰ Current § 229.2(k) generally follows the definition of "check" from the EFA Act and does not include an electronic image or electronic information within the definition of "check."

²¹ With respect to checks and returned checks handled by the Federal Reserve Banks, Regulation J (12 CFR part 210) provides protections to banks receiving electronic items from a prior bank. Clearinghouse rules also typically include such protection.

²² That is, warranties that a bank will not be asked to pay an item twice and that the electronic image and electronic information are sufficient to create a substitute check.

electronic image or electronic information related to a check or returned check. The Board also proposed to apply the provisions of subpart C to banks that send and receive these items by agreement as if they were checks, unless otherwise agreed by the sending and receiving banks.²³ The majority of commenters agreed with the Board's proposed definition of electronic check and electronic returned check and its proposal to apply the provisions of subpart C to these items as if they were checks.²⁴ Therefore, the Board has adopted the proposal as its final rule with clarifying changes so that "electronic check" and "electronic returned check" are now defined as an electronic image *and* electronic information *derived from* a check or returned check, for the reasons discussed in detail below in the section-by-section analysis.

The Board also proposed to apply existing paper-check warranties and the Check-21-like warranties to electronic checks and electronic returned checks.²⁵ The existing paper-check warranties include the returned-check warranties; the notice of nonpayment warranties; the settlement amount, encoding, and offset warranties; and the transfer and presentment warranties related to a remotely-created check. The Check-21-like warranties include warranties that a bank will not be asked to pay an item twice and that the electronic image and electronic information are sufficient to create a substitute check. These warranties ensure that a bank that receives a check for collection, presentment, or return receives the same warranties regardless of whether the check is in paper or electronic form. Commenters generally agreed with the proposal, and the Board believes that extending the warranties is important to create adequate protections. In the final rule, the Board has applied the existing paper-check warranties and the Check-21-like warranties to electronic checks and electronic returned checks as proposed.

The Board proposed to add new indemnities for electronically-created items, which are check-like items created in electronic form that never existed in paper form. Electronically-

²³ Pursuant to existing § 229.37 of subpart C, the parties could, by agreement, vary the effect of the provisions of subpart C as they apply to electronic checks and electronic returned checks.

²⁴ As defined in the final rule, whether the sending bank and the receiving bank have an agreement to send the item electronically determines if an item qualified as an "electronic check" or an "electronic returned check."

²⁵ Specifically, the Board proposed to apply the paper-check warranties in current § 229.34 to electronic checks and electronic returned checks.

created items can be difficult to distinguish from electronic images of paper checks. The Board proposed that a bank transferring an image or information that is *not* derived from a paper check (*i.e.*, an electronically-created item) indemnifies each transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against any loss, claim, or damage that results from the fact that the image or information was not derived from a paper check. The Board also proposed limiting the amount of the indemnity so that it would not exceed the amount of the loss of the indemnified bank, up to the amount of settlement or other consideration received by the indemnifying bank and interest and expenses of the indemnified bank (including costs and reasonable attorney's fees and other expenses of representation). Commenters generally agreed that the Board in its final rule should provide some sort of protection for the handling of electronically-created items, but there was no consensus about whether the Board's proposed indemnities or an alternative, such as warranties, was most appropriate. Some of these commenters supported applying protections to receivers of electronically-created items similar to those for checks or substitute checks.

The Board has adopted in the final rule the indemnities for electronically-created items as proposed, and in response to comments received, new indemnities for losses caused by the fact that (1) the electronically-created item was not authorized by the account holder and (2) a subsequent bank pays an item that has already been paid.²⁶ The Board believes that these indemnities will provide basic protections for banks handling electronically-created items that are unauthorized or presented more than once. In the final rule, the Board also defines "electronically-created item" to mean an electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and not from a paper check.

Finally, the Board proposed to add a new indemnity for remote deposit capture that would indemnify a depository bank that received a deposit of an original paper check that was returned unpaid because the check was previously deposited using a remote

deposit capture service and paid. Commenters expressed concern that as proposed, the indemnity would deter financial institutions from offering remote deposit capture service, thereby inhibiting its growth. Many of these commenters believed that the indemnity should not apply to checks bearing a restrictive indorsement.

The Board believes that the indemnity places appropriate incentives on the parties best positioned to prevent multiple deposits of the same item and has adopted the proposed indemnity. Based on comments received, the Board has added an exception to the indemnity that would prevent an indemnified bank from making an indemnity claim if it accepted an original check containing a restrictive indorsement that is inconsistent with the means of deposit, such as "for mobile deposit only."

D. Effective Date

The Board proposed a six month effective date following publication of the final rule and requested comment on whether it was sufficient. The Board received 17 comments regarding the proposed effective date. Four commenters agreed that a six month effective date was sufficient. Twelve commenters requested a 12 month effective date and stated that a longer effective date will allow financial institutions to make the necessary technology, policy, and consumer disclosure changes. One commenter requested an 18–24 month effective date. The Board has adopted an effective date of July 1, 2018. The Board believes that this time period will allow financial institutions to adjust their systems to comply with the final rule.

E. Additional Aspects of the Proposal

The Board also proposed several other minor amendments to subparts A, C, and D, and the accompanying commentary. The Board's proposed revisions, the comments the Board received, and the Board's final rule are described in additional detail in the section-by-section analysis.

F. Consultation With Other Agencies

As directed by section 609(e) of the EFA Act, the Board consulted with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, and the National Credit Union Administration Board during the rulemaking process.²⁷

III. Legal Authority

In issuing the final rule, the Board is exercising its authority under sections 609(b) and (c) and 611(f) of the EFA Act and section 15 of the Check 21 Act to amend subparts C and D, and, in connection therewith, subpart A, of Regulation CC to provide incentives for depository banks to receive, and paying banks to send, returned checks electronically and to allocate liability among depository institutions related to check collection and return.

IV. Section-by-Section Analysis

The paragraph citations in this section are to the paragraphs of the final rule unless otherwise stated.²⁸

A. General

1. § 229.1(b)—Authority and Purpose; Organization

Regulation CC currently describes the scope and purpose of subparts A through D in § 229.1(b). The Board proposed to add similar descriptions for each of Regulation CC's appendices. The Board did not receive comments on proposed § 229.1(b). The Board has adopted § 229.1(b) as proposed, with additional technical amendments to reflect the adoption of § 229.30(a), discussed below.

B. Definitions

1. Section 229.2(z)—Paying Bank

The current commentary to § 229.2(z) explains that for purposes of subparts C and D, paying bank includes the bank through which a check is payable and to which the check is sent for payment or collection, regardless of whether the check is payable by another bank. The Board proposed to eliminate outdated cross-references in paragraph 2 of the commentary and make other editorial changes. The Board did not receive any comments on the proposed commentary to § 229.2(z) and has adopted it as proposed with minor technical changes for clarity.

2. Section 229.2(dd)—Routing Number

Regulation CC currently defines the term "routing number" as the number printed on the face of the check or the number in the bank's indorsement. The Board proposed revising the definition of "routing number" for purposes of subpart C and subpart D to include a bank-identification number contained in an electronic image or electronic information. The Board also proposed revising the commentary to the

²⁶ Each bank that transfers or presents an electronically-created item and receives a settlement or other consideration indemnifies each transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank.

²⁷ 12 U.S.C. 4008(e).

²⁸ Where the Board has renumbered a section, the Board has made corresponding corrections to cross-references in other sections of the final rule-text.

definition of “routing number” to address electronic checks and to clarify that, in the case of payable-through checks, the routing number appearing on the check is that of the payable-through bank.

Two commenters requested that the Board distinguish between active routing numbers and those that are retired or never issued. One commenter requested that the Board provide clear authority to collecting banks to return or reject routing numbers that are listed as retired.

In the final rule, the Board has defined “routing number” as proposed, except that the terms “electronic check and electronic returned check” are used instead of “electronic image of or electronic information derived from a check” because the former terms are now defined.²⁹ With respect to the comments on retired routing numbers, Regulation CC does not affect a collecting bank’s ability to accept or reject a check for collection. For example, in 2015 the Federal Reserve Banks revised Operating Circular 3, governing their check service, to provide that the Federal Reserve Banks will not handle checks drawn on routing numbers that have been retired by the American Bankers Association’s Registrar of Routing Numbers.

3. Section 229.2(uu)—Indemnifying Bank

In connection with the new indemnity the Board proposed for “electronic image or electronic information not related to a paper check” and the newly defined term “electronically-created item,” the Board has revised § 229.2(uu) to clarify that the term “indemnifying bank” means a bank that provides an indemnity under § 229.53 with respect to a substitute check or a bank that provides an indemnity under § 229.34 with respect to remote deposit capture or an electronically-created item.

4. Section 229.2(vv)—MICR Line

Regulation CC currently defines “MICR line” as the numbers printed near the bottom of a check in magnetic ink, in accordance with American National Standard (ANS) Specifications for Placement and Location of MICR Printing, X9.13 for an original check and ANS Specifications for an Image Replacement Document—IRD, X9.100–140 for a substitute check, unless the Board by rule or order determines that different standards apply.

²⁹ Although the term “routing number” is used in subpart B, amendments to subpart B must be joint with the CFPB. Accordingly, the amendments apply only for purposes of subparts C and D.

The Board proposed to amend the definition of “MICR line” for purposes of subpart C and subpart D so that it also includes the numbers contained in an electronic image of and electronic information related to the check in accordance with ANS Specifications for Electronic Exchange of Check Image Data—Domestic, X9.100–187, unless the Board determines by rule or order that different standards apply. The Board proposed to revise the commentary to the definition of “MICR line” to state that the banks exchanging the electronic check may determine the applicable standard for electronic checks and electronic returned checks. The Board requested comment on whether the “MICR line” definition should specify an industry standard at all, given that the exchange of electronic items between banks is by agreement.

One Federal Reserve Bank commenter stated that electronic items and electronic returned items do not have a MICR line per se, but rather the MICR-line information is contained in the data records that accompany the image. The commenter suggested that the Board expand the proposed definition to include data contained in those records, as specified in the industry standard. The commenter also stated that the Board should tie the definition to generally accepted industry standards rather than using the currently prevailing standards so that the Board would not have to use a notice and comment process to move from one iteration of the standard to the successor version. One commenter also proposed creating an identifier for a remotely captured check in the MICR line.

In the final rule’s definition of “MICR line,” the Board has incorporated the data records that accompany the image, as specified for MICR line data in the industry standard. The final rule, like the proposed rule, ties the “MICR line” definition to the specified standard. The Board does not believe that tying the definition to generally accepted industry standards provides sufficient clarity for the parties involved and believes that tying the definition to the specified standard is more appropriate to provide banks with certainty. Banks can vary this rule by agreement to accept a future standard or an alternate specification. If industry standards are revised in the future, the Board will consider updating the references to these standards.

5. Section 229.2(bbb)—Copy and Sufficient Copy

The terms “copy” and “sufficient copy” were added to Regulation CC in 2004 in connection with the adoption of

the final rule implementing the Check 21 Act.³⁰ The term “copy” is used throughout subpart C (for example, in connection with the notice in lieu of return provisions) and the definition is limited to paper reproductions of checks.

The Board proposed to expand the current definition of “copy” to include an electronic reproduction of a check that a recipient has agreed to receive from the sender instead of receiving a paper reproduction.

Regulation CC currently defines a “sufficient copy” as a copy of an original check that accurately represents all of the information on the front and back of the original check as of the time the original check was truncated or is otherwise sufficient to determine whether or not a claim (such as an indemnity claim or an expedited recredit claim) is valid.

The Board did not propose to revise the current definitions of “copy” or “sufficient copy.” The Board, however, proposed to clarify the current commentary to the definition to clarify that a “sufficient copy,” which is used to resolve claims related to the receipt of a substitute check, must be a copy of the original check (and not of the substitute check). The Board received one comment supporting the proposal and no opposing comments. The Board has adopted proposed § 229.2(bbb) and the related commentary as proposed.

6. Section 229.2(fff)—Remotely Created Check

Regulation CC currently defines a “remotely created check” as a check that is not created by the paying bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn. Regulation CC places liability for unauthorized remotely created checks on the depository bank.³¹

The Board requested comment on whether it should narrow the scope of the definition of “remotely created check” to include only checks created by the payee (or payee’s agent), as opposed to the current definition’s scope of checks “not created by the paying bank.”³² The Board also requested comment on (1) the extent to which depository banks are receiving warranty claims related to checks that were not created by their customers or agents, (2) the extent to which paying

³⁰ 69 FR 47290, 47309 (Aug. 4, 2004).

³¹ See § 229.34(b) of the final rule, formerly § 229.34(d).

³² Such a change would exclude, for example, checks created by the account-holder independently or through a bill-paying service (other than a service offered by the paying bank).

banks may be inadvertently making warranty claims for items that had been created by the paying bank, and thus were not covered by the definition of “remotely created check,” and (3) what the substance of the warranties should be were the Board to narrow the definition of “remotely created check.” In addition, the Board requested comment on whether the Board should revise the definition of “remotely created check” to include items bearing “signatures” that were obtained electronically from the drawer and resemble the drawer’s handwritten signature.

Six commenters, including a comment letter submitted by a group of institutions and trade associations (“group letter”), addressed remotely created checks. Two commenters stated that the Board should not narrow the definition of remotely created check. One of these commenters stated that there is no discernable difference between remotely created checks created by payees and paying banks and that narrowing the definition of a remotely created check would lead to confusion in the handling of these items. Four commenters, including the group letter, suggested that the Board narrow the definition to include only checks created by the payee or payee’s agent. These commenters stated that because the warranty shifts loss from the paying bank to the depository bank, the warranty should apply only in situations where the payee or payee’s agent created the check. The commenters stated that in situations where the account-holder instructs its own bill-paying agent to create the check, the depository bank should not be held liable if the account-holder later claims such check was not authorized.

The Board did not receive any comments on the extent to which depository banks are receiving remotely created check warranty claims related to checks that were not created by the depository banks’ customers or their agents. The Board did not receive any comments on whether it should revise the definition of remotely created check to include items bearing “signatures” that were obtained electronically from the drawer and resemble the drawer’s handwritten signature.

In the final rule, the Board has not modified the definition of remotely created checks. Under the current definition, in order to assert a warranty claim, the parties to a check do not have to distinguish between checks that are created by the payee or its agent from other checks, such as checks created by a customer’s bill-payment service. In the absence of any evidence that the

warranty has been broadly asserted on checks created by account-holders, the Board continues to believe that this definition is operationally efficient for paying banks because they more easily can determine whether the warranty applies to a particular check.

7. Section 229.2(ggg)—Electronic Check and Electronic Returned Check

The current definition of “check” in Regulation CC does not include electronic images and electronic information. The Board proposed the addition of § 229.2(ggg) setting forth two new defined terms, “electronic check” and “electronic returned check.” The proposal defined “electronic check” and “electronic returned check” as (1) an electronic image of a check, or returned check, or electronic information related to a check, or returned check, respectively, that a bank or a nonbank depositor sends to a receiving bank pursuant to an agreement with the receiving bank, and (2) that conforms with ANS Specifications for Electronic Exchange of Check Image Data—Domestic, X9.100—187, unless the Board determines that a different standard applies or the parties otherwise agree. The proposal permitted the sending and receiving banks to agree that an “electronic check” or an “electronic returned check” need not contain both an electronic image and electronic information. Under the proposal, an item could be an “electronic check” or “electronic returned check,” even if it is not sufficient to create a substitute check, but the sending bank would warrant that such items are sufficient to create substitute checks, unless otherwise agreed.³³

The proposed commentary to § 229.2(ggg) clarified that the terms of the agreements for sending and receiving electronic checks and returned checks may vary. For example, banks may agree that both an electronic image and electronic information must be provided for presentment, or they may agree that the electronic information alone is sufficient for presentment. Additionally, the agreements may differ as to what constitutes receipt of an electronic check or electronic returned check.

One commenter suggested that the Board define an “electronic check” and an “electronic returned check” so that the electronic record would be effectively equivalent to a check only if the electronic record includes an image and data from the paper check, rather than the proposed definition specifying

image or data. The commenter emphasized the importance of both image and data, especially in complex use cases, such as instances in which the check names multiple payees that each must indorse the check before it can be properly negotiated.

To address the concerns raised by this commenter, the Board in the final rule has defined “electronic check” and “electronic returned check” to mean “an electronic image of, and electronic information derived from, a paper check or paper returned check.” The Board has also revised its proposed definition to refer to electronic information “derived from” (rather than “related to”) a paper check or paper returned check. This revision addresses another commenter’s concern that electronic check and electronic returned check (which are derived from paper checks) may be read to apply to electronically-created items (which are not derived from paper checks). The Board has also revised its proposed definition to refer to electronic information derived from a *paper* check or *paper* returned check, as the term “check” in subpart C includes electronic checks and electronic returned checks unless otherwise specified, pursuant to section 229.30.

8. Section 229.2(hhh)—Electronically-Created Item

The Board proposed a new indemnity for an “electronic image or electronic information not related to a paper check” in proposed § 229.34(b). One commenter suggested that the Board consider formally defining an electronically-created item. In the final rule, the Board has adopted in § 229.2(hhh) a newly defined term, “electronically-created item,” to refer to the items covered by the new indemnity. The Board has also adopted accompanying commentary. The Board has defined this term to mean “an electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and not derived from a paper check.”

C. Subpart C—Collection of Checks

The Board proposed two alternative approaches to the requirements that apply to the return of checks, which are outlined above. Also as explained above, the Board has adopted a final rule that incorporates elements of both proposed Alternative 1 and Alternative 2. Under the final rule, all returned checks, both paper and electronic, are subject to a modified version of the “two-day test,” meaning that they must be returned in an expeditious manner, such that the check would normally be

³³ See § 229.34(a).

received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank. The Board also added a new section that prevents a depository bank from asserting a claim against a paying bank or returning bank for failure to return a check in an expeditious manner unless the depository bank has arrangements in place such that the paying bank or returning bank could return the check to the depository bank electronically, directly or indirectly, through commercially reasonable means. The depository bank has the burden of proof for demonstrating that its arrangements for accepting returned checks electronically are commercially reasonable. In addition, if a paying bank determines not to pay a check in the amount of \$5,000 or more, it must provide a notice of nonpayment such that the notice would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank.

1. Section 229.30—Electronic Checks and Electronic Information

a. Section 229.30(a)—Checks Under This Subpart

The Board proposed that electronic checks and electronic returned checks be subject to the provisions of subpart C as if they were checks or returned checks, unless the subpart provides otherwise. The Board noted in proposed commentary to § 229.30(a) that § 229.37 permits banks to vary by agreement the effect of the provisions in subpart C as they apply to electronic checks and electronic returned checks.

The Board received 14 comments on proposed § 229.30(a). Eight commenters generally supported the Board's proposal to apply the terms of subpart C to "electronic checks" and "electronic returned checks" as if they were checks, unless otherwise agreed by the sending and receiving banks. Five commenters expressed concerns that this could result in increased risks to banks because electronic checks and electronic returned checks are currently governed by agreements between banks and that the Board should address and limit any increased risks. One commenter suggested that the Board specify the provisions that the sending banks and receiving banks may vary by agreement to avoid confusion. The commenter also suggested that the Board set a ceiling on a dollar amount of checks that could be

electronically returned so that all parties know the level of risk they would be assuming by accepting electronic returns.

Given that electronic checks and electronic returned checks are currently governed by agreements between banks, the Board believes that the commentary and rule text as proposed provide sufficient clarity as to the ability of banks to vary by agreement the effect of the provisions in subpart C as they apply to electronic checks and electronic returned checks to address and limit any perceived risks. The Board has not set a ceiling on the dollar amount of checks that could be electronically returned, as the Board believes that banks are in the best position to determine their risk tolerance. The Board has adopted § 229.30(a) and provided clarification by replacing "unless otherwise provided" with "except where 'paper check' or 'paper returned check' is specified." The Board has also provided additional examples of the application of § 229.30(a) in the commentary and clarified that where "check" or "returned check" is used in subpart A it includes also "electronic check" or "electronic returned check" for the purposes of subpart C, except where "paper check" or "paper returned check" is specified.

b. Section 229.30(b)—Writings

In proposed § 229.30(b), the Board would permit, under certain circumstances, a bank required to provide information in writing or in written form under subpart C to satisfy that requirement by providing that information in electronic form. Specifically, the receiving bank would have to agree to receive that information electronically from the sending bank. In proposed commentary to § 229.30(b), the Board provided as an example that a bank could send a notice in lieu of return electronically if the receiving bank agreed to receive the notice electronically. The Board did not receive any comments on proposed § 229.30(b) and has adopted it as proposed with minor technical edits.

2. Section 229.31—Paying Bank's Responsibility for Return of Checks and Notices of Nonpayment

a. Section 229.31(a) and (b)—Return of Checks and Expeditious Return of Checks

Current § 229.30(a) provides that a paying bank must return a check in an expeditious manner (as measured by either the two-day/four-day test or the forward-collection test) and that a

paying bank may send a returned check to the depository bank or to any other bank agreeing to handle the returned check expeditiously. It also provides that a paying bank may convert a check to a qualified returned check (and sets forth format standards for qualified returned checks) and that the expeditious return requirements do not affect a paying bank's responsibility to return a check within the deadlines required by the UCC, Regulation J, or current § 229.30(c).

Current § 229.30(b) provides that a paying bank unable to identify the depository bank may send the returned check to any bank that handled the check for forward collection even if that bank does not agree to handle the check expeditiously under current § 229.31(a). The paying bank must advise the bank to which the check is sent that the paying bank is unable to identify the depository bank. The expeditious return requirements of current § 229.30(a) do not apply to the paying bank's return of a check when the paying bank is unable to identify the depository bank.

The Board proposed two alternative approaches to revising these provisions. With Alternative 1, the Board proposed elimination of the expeditious return requirement imposed on a paying bank. Accordingly, the Board proposed to remove the provisions setting forth the two-day/four-day test and the forward-collection test, as well as to remove all references to expeditious return from the regulation and the commentary.

Alternative 2 would retain an expeditious return requirement consistent with a two-day test, such that the check would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank.

Alternative 2 would move the cutoff hour for receipt of a returned check from 4 p.m. to 2 p.m. (local time of the depository bank), consistent with similar changes elsewhere in the proposal. In addition, Alternative 2 would modify the existing rule by providing that, where the second business day following presentment is not a banking day for the depository bank, the paying bank satisfies the expeditious return requirement if it sends the returned check in a manner such that the depository bank would *normally* receive the returned check on or before the depository bank's next banking day. (Proposed new language italicized.)

Both Alternatives 1 and 2 would have retained the existing provisions permitting a paying bank that is

returning a check to send the returned check directly to the depository bank, to any other bank agreeing to handle the returned check, or to any bank that handled the check for forward collection when the paying bank is unable to identify the depository bank. In Alternative 2, however, a paying bank's choice of return path would be subject to the requirement for expeditious return.

In addition, under both alternatives, the Board proposed to revise the commentary to the provision on handling checks where the depository bank is not identifiable. The proposed new commentary would provide an example related to a check presented electronically, stating that a paying bank would be unable to identify the depository bank if the depository bank's indorsement is neither in an addenda record nor within the image of the check that was presented electronically.³⁴ A paying bank, however, would not be "unable" to identify the depository bank merely because the depository bank's indorsement is available within the image, and the paying bank must retrieve and visually review the image, rather than attached as an addenda record. Like the current commentary, the proposed commentary for both alternatives would have required a paying bank returning a check to a prior collecting bank because it is unable to identify the depository bank to advise the prior collecting bank of this fact. The Board noted in the proposed commentary that, in the case of an electronic returned check, the advice requirement may have been satisfied in such a manner as the parties agree.

Under both alternatives, the Board would have preserved the ability of a paying bank to convert a check into a qualified returned check and the format standards for doing so as well as the statement that the section does not affect a paying bank's responsibility to return a check within the deadlines required by the UCC, Regulation J, or proposed § 229.31(g), relating to the midnight deadline extension.

Seven commenters preferred Alternative 1 (elimination of the expeditious return requirement), 10 commenters, including the group letter, preferred Alternative 2 (maintaining the two-day test for expeditious-return), and eight commenters preferred neither. Commenters that supported Alternative 1 believed that the option had the least financial and operational effect on depository institutions. Commenters

that supported Alternative 2 expressed doubt as to whether Alternative 1, which would eliminate the expeditious return requirement, would provide sufficient incentives for depository institutions to accept electronic returns. The commenters that preferred neither alternative stated that a significant number of smaller depository institutions still relied on paper returns. Some commenters suggested that the Board retain the forward-collection test in addition to the two-day expeditious return requirement, as it would facilitate paying bank compliance when there is uncertainty regarding how the paying bank's returning banks can handle a particular return item.

After considering the comments, the Board has adopted proposed Alternative 2's two-day expeditious return rule requirement for § 229.31(a) and (b).³⁵ As described in more detail in Section II above, the Board believes that maintaining the two-day test for expeditious-return, along with the other return requirements, offers the appropriate incentives for banks to accept electronic returns.

The Board did not receive comments on the other aspects of the return process in Alternative 2 for proposed § 229.31(a) (dealing with routing of returned checks and creation of qualified returned checks) or the corresponding commentary. Consistent with maintaining an expeditious return requirement, the Board has adopted those provisions with minor technical changes for clarity. The Board has also adopted the specific requirements for expeditious return by a paying bank as set forth in Alternative 2 for proposed § 229.31(b), with minor technical changes for clarity and revisions to align the commentary with the Board's final amendments to § 229.33(a).

b. Section 229.31(c)—Notice of Nonpayment

Notice of nonpayment requirement (§ 229.31(c)(1)). Current section 229.33(a) of Regulation CC requires that, if a paying bank determines not to pay a check in the amount of \$2,500 or more, it must provide notice of nonpayment such that the notice is received by the depository bank by 4 p.m. (local time of the depository bank) on the second business day following

the banking day on which the check was presented to the paying bank. The notice may be provided by any reasonable means, including the returned check, a writing (including a copy of the check), telephone, Fedwire, telex, or other form of telegraph. Current commentary to § 229.33(a) explains that the return of the check itself may serve as the notice, so long as the returned check would be received by the depository bank within the time limits for the notice. The commentary further explains that in determining whether the returned check will satisfy the notice requirement, the paying bank may rely on the availability schedules of returning banks as the time that the returned check is expected to be delivered to the depository bank, unless the paying bank has reason to know the availability schedules are inaccurate.

The Board proposed two alternative approaches to revise this provision. Proposed Alternative 1 would have retained a notice of nonpayment requirement, but only if the paying bank sent the returned check in paper form. The notice of nonpayment requirement, however, would apply regardless of the dollar amount of the check being returned. Under Alternative 1, the Board proposed to move the deadline by which a notice of nonpayment must be received by the depository bank from 4 p.m. to 2 p.m. (local time of the depository bank) on the second business day following the banking day of presentment. The proposed 2 p.m. deadline would be consistent with banks' generally applicable cutoff hour for receipt of checks under section 4-108 of the UCC, after which a bank may consider an item to be received on its next banking day. Alternative 1 would eliminate the statement in the commentary to current § 229.33(a) that the paying bank may rely on the availability schedules of returning banks as the time that the returned check is expected to be delivered to the depository bank. That statement was inconsistent with the regulatory text providing for a fixed deadline for the depository bank's receipt of notice of nonpayment. Furthermore, the Board proposed in Alternative 1 to delete references to Fedwire, telex, or other form of telegraph, although the use of these means of providing notice would nonetheless remain acceptable. Proposed Alternative 2 would have eliminated the notice of nonpayment requirement.

Most commenters supported Alternative 1, which would have retained the notice of nonpayment, whether or not they supported retention of the expeditious return requirement.

³⁴ The Board expects that these cases will be unusual as depository banks generally apply their indorsements electronically.

³⁵ As discussed in greater detail below, under § 229.33(a)(1) of the final rule, a paying bank or returning bank may be liable to a depository bank under § 229.38 for failing to return a check in an expeditious manner only if the depository bank has arrangements in place such that the paying bank or returning bank could return a returned check to the depository bank electronically, directly or indirectly, by commercially reasonable means.

Numerous commenters suggested increasing the threshold for the notice of nonpayment, such as to \$5,000 or \$10,000. Several commenters, including the group letter, suggested that there may still be a need to maintain a requirement for high-dollar item notification of non-payment for all items—both paper and electronic—to protect the depositary banks from a loss in high-dollar item situations.

One commenter, the group letter, did not support the requirement that the depositary bank receive the notice of nonpayment by 2 p.m. The group letter stated that the paying bank often relies on a third-party service provider to assist with the delivery of notices of nonpayment, and should be able to rely on the third party's availability schedule that establishes when the notice of nonpayment will be received by the depositary bank.

The Board has adopted in § 229.31(c)(1) and its accompanying commentary Alternative 1 of the proposal and the proposed accompanying commentary with modifications. The Board agrees with commenters that notice of nonpayment requirements will reduce risks to depositary banks for all returned items, and therefore the notice requirement adopted by the Board applies regardless of whether the paying bank sends a paper or electronic return. The Board believes that paying banks will have incentives to send returns electronically in order to avoid the likelihood that they would fail to meet their expeditious return obligations using paper returns, as described below.

The Board has also increased the threshold for notice from \$2,500 to \$5,000. The Board has also revised the notice of nonpayment requirement to require a paying bank to provide notice to the depositary bank such that the notice "would normally be received" by 2 p.m. The commentary also clarifies that a paying bank may rely on the availability schedule of a third party that provides the notices of nonpayment on its behalf. This approach parallels that of the expeditious return requirement.

Content of notices (§ 229.31(c)(2)). Section 229.33(b) currently requires a paying bank to include the following information in a notice of nonpayment: (1) Name and routing number of the paying bank; (2) name of the payee(s); (3) amount of the check being returned; (4) date of the indorsement of the depositary bank; (5) account number of the customer(s) of the depositary bank; (6) branch name or number of the depositary bank from its indorsement; (7) trace number associated with the

indorsement of the depositary bank; and (8) reason for nonpayment.

The Board offered two alternative approaches to revise this provision. Proposed Alternative 1 would have required the paying bank to include the specified information in a notice of nonpayment only to the extent it is available to the paying bank. In addition, the Board proposed in Alternative 1 that the notice include, to the extent available to the paying bank, the information contained in the check's MICR line when the check is received by the paying bank. The check's MICR line would typically include the account number of the paying bank's customer, the check's serial number, and, if the check is a corporate-sized check, the auxiliary-on-us field. In Alternative 1, the Board also proposed that the notices include essentially all the other information required in current § 229.33(b), to the extent available to the paying bank.³⁶ In addition, Alternative 1 proposed retention of the statement in current § 229.33(b) that, if the paying bank is not sure of the accuracy of an item of information, it shall include the required information to the extent possible and identify any item of information for which the bank is not sure of the accuracy.

Proposed Alternative 2 would have eliminated the requirement of the notice of nonpayment.

The Board received one comment, the group letter, on the content of the notice of nonpayment. The group letter supported inclusion of MICR line information as a data element in the notice. However, the group letter recommended elimination of the requirement to include the account number of the depositing customer and the branch name or number of the depositary bank from its indorsement. The group letter stated that a depositary bank would rely solely on its own check processing or deposit account system for this information. The group letter also suggested elimination of the requirement to include the name of the paying bank because the depositary bank should rely on the identity of the paying bank that is associated with the MICR line routing number information. In addition, the group letter recommended elimination of the requirement that the paying bank include and identify in the notice those data elements about which the paying bank is uncertain as to their accuracy.

³⁶ The Board proposed deleting the requirement to include the paying bank's routing number because the paying bank's routing number would already be set forth in the MICR line of the check.

The group letter noted that this type of statement is infrequently used and that paying banks typically do not have a means of knowing which information is uncertain as to accuracy. Furthermore, the letter states that there is no standardized code or symbol that is agreed upon within the check industry for a bank to indicate uncertainty.

The Board agrees that including the account number of the depositing customer and the branch name or number of the depositary bank from its indorsement is of little use to the depositary bank because it will rely on its own systems to determine that information. The Board also agrees that the name of the paying bank is not necessary because banks will rely on the identity of the paying bank that is associated with the MICR line routing number information.³⁷ The Board recognizes that there is no standardized code or symbol agreed upon within the check industry, but also believes that there are instances in which an indicator of uncertainty is useful, such as for a handwritten check with a payee name that is difficult to decipher.

The Board has adopted as its final rule in § 229.31(c)(2)(i) Alternative 1 of the proposal, but has eliminated the content requirements of the account number of the depositing customer, the branch name or number of the depositary bank from its indorsement, and the name of the paying bank. The Board has adopted as its final rule in § 229.31(c)(2)(ii) the provision regarding the uncertainty indicator as proposed with clarifications in the commentary that banks may indicate uncertainty, such as with a question mark, in accordance with general industry practices or as otherwise agreed to by the parties.

c. Section 229.31(d)—Exceptions to the Expeditious Return of Checks and Notice of Nonpayment

Depositary banks that are not subject to subpart B (§ 229.31(d)(1)). Current §§ 229.30(e) and 229.33(e) state that the expeditious return requirements and the notice of nonpayment requirements, respectively, do not apply with respect to checks deposited in a depositary bank that does not maintain accounts (as defined in Regulation CC), because that depositary bank is not subject to the funds availability requirements of subpart B. The Board proposed to retain the substance of these exceptions as relevant to Alternative 1 (exceptions to

³⁷ The information requirements in the final rule for a notice of nonpayment are consistent with the information requirements for an electronic returned check, which often serves as the notice.

notice of nonpayment requirement) and Alternative 2 (exceptions to expeditious return requirement) when the check is being returned to a depository bank that is not subject to subpart B (either because the depository bank does not maintain “accounts” or because the depository bank is not a “depository institution” under the EFA Act). The Board did not receive any comments on the proposed alternatives and has adopted them as proposed at § 229.31(d)(1).

Unidentifiable depository bank (§ 229.31(d)(2)). Current § 229.30(b) of Regulation CC provides that the expeditious return requirement of current § 229.30(a) does not apply to the paying bank’s return of a check if the depository bank is unidentifiable. However, current § 229.33 of Regulation CC does not exempt a paying bank from the notice of nonpayment requirement when the depository bank is unidentifiable.

The Board proposed that neither the expeditious return nor notice of nonpayment requirement would apply if the paying bank cannot identify the depository bank with respect to the returned check. One commenter, the group letter, supported these revisions. The Board has adopted these exemptions as proposed at § 229.31(d)(2) with minor technical changes for clarity.

Other proposed exception to expeditious return requirement. Under Alternative 2, the Board proposed that a paying bank would not be subject to the expeditious return requirement if it does not have an agreement to send electronic returned checks to the depository bank or to a returning bank that is subject to the expeditious return requirement for that check. Thus, under Alternative 2, a paying bank would not be subject to the expeditious return requirement when it or the depository bank did not agree to accept returned checks electronically.

Under proposed Alternative 2, a paying bank could avoid the expeditious return requirement by choosing to send returned checks only in paper form. In its discussion of Alternative 2, the Board suggested that it would be unlikely that a paying bank would make such a choice in order to avoid the expeditious return requirement, given that paying banks would have a cost incentive to return checks electronically whenever possible. In addition, a paying bank would be subject to the expeditious return requirement under Alternative 2 if it had the necessary agreements to send electronic returned checks, but nevertheless chose to send paper

returned checks. The Board requested comment on whether it should impose a limit—longer than two business days—on the timeframe within which a *paper* returned check must be received by the depository bank.

Commenters stated that it would be difficult for a paying bank to know whether or not it had an electronic return arrangement with the depository bank through its returning bank as set forth in Alternative 2, resulting in uncertainty as to whether or not the paying bank would be subject to the expeditious return requirement. Additionally, commenters were concerned that some banks would decide not to have an agreement with a returning bank or depository bank to accept electronic returns so that they would not be subject to the expeditious return requirement.

The Board recognizes that although Alternative 2 provided an incentive to the depository bank to accept electronic returns, it did not provide strong incentives to the paying bank to send electronic returns. The Board also agrees that determining in advance of returning a check whether the expeditious return exception applied under Alternative 2 could be difficult in some cases.

Therefore, as discussed above, the Board has not adopted Alternative 2 in its final rule. Rather, all paying banks and returning banks are subject to the expeditious return rule, regardless of whether they return checks electronically or via paper. The final rule, discussed further below, § 229.33(a) limits the expeditious return liability in certain cases. Specifically, a paying or returning bank may be liable to a depository bank for failing to return a check in an expeditious manner only if the depository bank has arrangements in place such that the paying or returning bank could return a returned check to the depository bank electronically by commercially reasonable means. The final rule places the burden on a depository bank that makes a claim for a violation of the expeditious return requirement to demonstrate that its arrangements are commercially reasonable.

d. Section 229.31(e)—Identification of Returned Check

Current § 229.30(d) states that a paying bank returning a check shall clearly indicate on the face of the check that it is a returned check and the reason for return. If the check is a substitute check, the paying bank shall place this information within the image of the original check that appears on the front of the substitute check. The Board proposed to revise the reference to the

“face” of the check to a reference to the “front” of the check. The Board also proposed to expand the second sentence of current § 229.30(d) to cover the return of either a substitute check or an electronic returned check and to specify that the reason for return must be included such that the information is retained on any subsequent substitute check. The Board proposed to revise the accompanying commentary to provide greater clarity on the circumstances in which “refer to maker” by itself may be used as a reason for return, such as when a drawer with a positive pay arrangement instructs the bank to return the check. The proposed commentary provided greater clarity on the circumstances in which “refer to maker” by itself would be an impermissible reason for return, such as when a check is being returned because the paying bank already paid the item. The proposed language explained that, in such cases, the payee and not the drawer would have more information as to why the check is being returned.

Three commenters, including the group letter, supported the use of “refer to maker” as an appropriate reason for return, stating that this reason is needed in the situation where a paying bank has suspicion of possible fraud of the check or account, but has insufficient information to form a conclusive view. Two commenters, including the group letter, agreed with the proposal that “refer to maker” should not be used in situations involving duplicate presentment.

In § 229.31(e) of its final rule, the Board has adopted the proposed regulatory language on reasons for return with minor technical changes for clarity. Based on the alternatives suggested by commenters, the Board also changed the words “permissible” and “not permissible” to “appropriate” and “inappropriate” in the commentary. Although some commenters suggested that the Board remove all reference to “refer to maker,” the Board retained references to “refer to maker” in the commentary to provide basic guidance to the industry and in recognition that “refer to maker” can be appropriate in some cases. Furthermore, the Board added two new examples—an altered or unauthorized check—of inappropriate uses of “refer to maker” to the commentary.

e. Section 229.31(f)—Notice in Lieu of Return

Current § 229.30(f) provides that, if a check is unavailable for return, the paying bank may send in its place a copy of the front and back of the returned check, or, if no such copy is

available, a written notice of nonpayment containing the information specified in current § 229.33(b).

The Board proposed to revise the information required to be included in a notice in lieu of return and in a notice of nonpayment. Proposed Alternative 1 provided that, if a check is unavailable for return, the paying bank may send in its place a copy of the front and back of the returned check, or, if no such copy is available, a written notice of nonpayment containing the information specified for such notices. Proposed Alternative 2, which did not contain a notice of nonpayment requirement, nevertheless would have required the same information as Alternative 1 for notices in lieu of return.

The Board also proposed several revisions to the commentary to the notice-in-lieu provisions. Specifically, the Board proposed to clarify in the commentary that notice by a legible facsimile of both sides of the check may satisfy the requirements for a notice in lieu of return. In addition, the Board clarified that a bank may send a notice in lieu of return as an electronic image of both sides of the check only if it has an agreement to do so with the receiving bank.

Two commenters, including the group letter, addressed the proposed notice in lieu of return provision. One commenter supported the Board's proposal. The group letter, as with the notice of nonpayment, recommended that the notice in lieu of return should not include the account number of the depositing customer and the branch name or number of the depository bank from its indorsement. The letter stated that a depository bank would rely solely on its own check processing or deposit account system for this information. The group letter also suggested that the notice in lieu of return should not include the name of the paying bank because the depository bank should rely on the identity of the paying bank that is associated with the MICR line routing number information.³⁸

Similar to the notice of nonpayment, the Board has adopted as its final rule the notice in lieu of return with clarification that the account number of the depositing customer, the branch name or number of the depository bank from its indorsement, and the name of the paying bank is not required. The Board has also revised the commentary

³⁸ One comment, received as part of the EGRPRA process, supported continued use of notice in lieu generally, stating that there are instances where the notice serves as the best method available to a credit union returning a check and the additional flexibility thus provides an important and continuing benefit.

to clarify examples of when notice in lieu of return is permissible.

f. Section § 229.31(g)—Extension of Deadline

Current § 229.30(c) provides that the deadline (as set forth in either the UCC, Regulation J (12 CFR part 210), or § 229.36 of Regulation CC) for return of a check or notice of nonpayment is extended to the time of dispatch where a paying bank uses a means of delivery that would ordinarily result in receipt by the bank to which it is sent (1) on or before the receiving bank's next banking day following the otherwise applicable deadline by the earlier of the close of that banking day or a cutoff hour of 2 p.m. or such later time as set by the receiving bank under UCC 4–108; (and further extended if a paying bank uses a "highly expeditious" means of transportation), or (2) prior to the cutoff hour of the next processing cycle (if sent to a returning bank), or on the next banking day (if sent to the depository bank), for a deadline falling on a Saturday that is a banking day for the paying bank under the UCC. (Saturday is never a banking day under Regulation CC.)

The Board also proposed to extend the deadline for return or notice of dishonor or nonpayment (Alternative 1) or for return or notice of dishonor (Alternative 2) to the time of dispatch only if the returned check or notice is *actually* received by the depository bank (or, in the case of an unidentifiable depository bank, the bank to which the return is sent) within the specified timeframe. Under the proposal, returned checks and notices must be received by the depository bank or receiving bank (1) on or before the receiving bank's next banking day following the otherwise applicable deadline by the earlier of the close of that banking day or a cutoff hour of 2 p.m. or such later time as set by the receiving bank under UCC 4–108 or (2) prior to the cutoff hour of the next processing cycle (if sent to a returning bank), or on the next banking day (if sent to the depository bank), for a deadline falling on a Saturday that is a banking day for the paying bank under the UCC.

As noted above, both Alternative 1 and Alternative 2 clarified that the extension would apply to the deadlines for notice of dishonor or nonpayment under the UCC. The Board intended that clarification to be non-substantive. The Board proposed to eliminate the existing further extension of the deadline if the paying bank uses a "highly expeditious" means of transportation, given the existing prevalence of electronic

return.³⁹ The Board proposed to clarify in the commentary that the paying bank may satisfy its midnight or other return deadline by sending an electronic returned check prior to the expiration of the deadline, if the paying bank has an agreement to do so with the receiving bank. The time when the electronic returned check is considered to be received by the depository bank is determined by the agreement.

One commenter, the group letter, addressed these proposed changes. The group letter supported the Board's proposed commentary that clarified when an item is received by the depository bank and agreed that the timing of the receipt of an electronic return by the depository bank is appropriately determined by agreement. The group letter recommended that the Board revise the proposed commentary specifically to refer to bilateral agreements and clearinghouse rules or operating circulars, instead just of agreements generally. The group letter also suggested that the Board review the commentary to indicate more clearly that the paying bank satisfies its return obligation under the UCC in the context of an electronic returned check when the paying bank sends the electronic returned check from the paying bank's location in accordance with the UCC midnight deadline.

The Board has adopted the proposed deadline extension in § 229.31(g) and the accompanying commentary with the addition of a reference in the commentary to bilateral agreements and clearinghouse rules or operating circulars. The commentary clearly states that a paying bank's sending of the electronic return after midnight, by agreement, satisfies the midnight deadline.

g. Section 229.31(h)—Payable-Through and Payable-at Checks

Current § 229.36(a) provides that a check payable at or through a paying bank is considered to be drawn on that bank for purposes of subpart C's expeditious return and notice of nonpayment requirements.⁴⁰ The Board proposed to move this provision to proposed § 229.31(h). The Board also proposed to move commentary addressing the treatment of payable-through or payable-at bank under the

³⁹ The example of "highly expeditious" means of transportation in the current commentary is a West Coast paying bank using an air courier to ship a returned check directly to an East Coast returning bank.

⁴⁰ A check sent for payment or collection to a payable-through or payable-at bank is not considered to be drawn on that bank for purposes of the midnight deadline provision of UCC 4–301.

midnight deadline provision of UCC 4-301 from current § 229.30(a) to the commentary for proposed § 229.31(h). The Board did not receive any comments on proposed § 229.31(h) and has redesignated current § 229.36(a) as proposed.

h. Section 229.31(i)—Reliance on Routing Number

Current § 229.30(g) provides that a paying bank may return a returned check based on any routing number designating the depository bank appearing on the returned check in the depository bank's indorsement. The Board proposed to redesignate this provision as § 229.31(i). The proposed commentary to § 229.31(i) provided that the paying bank also may rely on any routing number designating the depository bank in the electronic check sent pursuant to an agreement when the electronic check is received by the paying bank.

The Board did not receive any comments on the redesignation or the proposed commentary to § 229.31(i). In § 229.31(i) of the final rule, the Board has adopted the provision and commentary as proposed.

3. Section 229.32—Returning Bank's Responsibility for Return of Checks

a. Section 229.32(a)—Return of Checks

Current § 229.31(a) sets forth a returning bank's expeditious return requirement and provides a two-day/four-day test and a forward-collection test for expeditious return, similar to the tests for paying banks described above. Under current § 229.31(a), a returning bank may send a returned check to the depository bank or to any bank agreeing to handle the returned check expeditiously. This section also provides that a returning bank may convert a check to a qualified returned check (and sets forth format standards for qualified returned checks) and provides a one-business-day extension under the forward-collection test and deadline for return under the UCC and Regulation J if the returning bank converts a check to a qualified returned check. The extension does not apply to the two-day/four-day test or to checks returned directly to the depository bank. Under current § 229.31(b), if a returning bank is unable to identify the depository bank, the returning bank may send the returned check to (1) any collecting bank that handled the check for forward collection if the returning bank was not a collecting bank with respect to the returned check; or (2) a prior collecting bank, if the returning bank was a

collecting bank with respect to the returned check.

Alternative 1 of proposed § 229.32 would eliminate the requirement that a returning bank return a check expeditiously. Accordingly, Alternative 1 would delete the two-day/four-day and forward-collection tests of current § 229.31(a) and would eliminate all references to expeditious return from the regulation and accompanying commentary. Proposed Alternative 2 would retain the expeditious return requirement for returning banks and the two-day test of current § 229.31(a). Both proposed alternatives would retain the provisions permitting a returning bank to send a returned check to the depository bank, to any bank agreeing to handle the returned check, or, if the depository bank is unidentifiable, to any collecting bank that handled the check for forward collection (if the returning bank was not a collecting bank with respect to the returned check) or to a prior collecting bank (if the returning bank was a collecting bank with respect to the returned check). In addition, both proposed alternatives would retain existing provisions that permit returning banks to convert a check to a qualified returned check. However, the provisions that permit a one-business-day extension for a qualified returned check would be eliminated in both proposed alternatives. Given the current prevalence of electronic check collection and return, such an extension does not appear to be operationally necessary or provide incentives for electronic handling.

The current commentary to § 229.31(a) explains that a returning bank agrees to handle a returned check for expeditious return if the returning bank publishes or distributes availability schedules for the return of returned checks and accepts the returned check for return; handles a returned check for return that it did not handle for forward collection; or otherwise agrees to handle a returned check. The Board proposed to clarify that a returning bank may send an electronic returned check directly to the depository bank if the returning bank has an agreement with the depository bank to do so. The Board also proposed to clarify in the commentary that a returning bank agrees to handle a returned check if it agrees with the paying bank or returning bank to handle electronic returned checks sent by that bank.

The Board did not receive any comments specifically concerning § 229.32(a). The Board has adopted Alternative 2 of § 229.32(a) as proposed, retaining the expeditious return

requirement for returning banks, with a two-day test. In addition, the Board has adopted the proposed regulatory and commentary text that appeared in both alternative proposals regarding unidentifiable depository banks, qualified returned checks, cut-off hours, and UCC sections affected.

b. Section 229.32(b)—Expeditious Return of Checks

Under Alternative 2 of proposed § 229.32(b), the Board would modify the existing rule in current § 229.31(a) for expeditious return of checks by a returning bank to require that a returning bank must return the check in a manner such that the check would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank.⁴¹ This returning bank's expeditious return requirement under Alternative 2 of proposed § 229.32(b) would be consistent with the paying bank's expeditious return requirement under Alternative 2 of § 229.31(b). In addition, Alternative 2 of proposed § 229.32(b) would eliminate the current provisions setting forth a four-day test for expeditious return of nonlocal checks (which no longer exist) and a forward-collection test, and would remove all references to those tests throughout the regulation and related commentary. The proposed commentary to Alternative 2 would retain language in the current commentary to § 229.31(a) describing when a returning bank is subject to the expeditious return requirement with respect to a returned check. The proposed commentary also would clarify that a returning bank could agree with the paying bank or another returning bank to handle returned checks sent by that paying bank or other returning bank for expeditious return to certain depository banks. The proposed commentary would have removed the current example that states that, in handling a returned check that it did not handle for forward collection, a returning bank agrees to return the check expeditiously.⁴²

The Board did not receive any comments specifically concerning § 229.32(b). The Board has adopted an expeditious return requirement for

⁴¹ As noted above, Alternative 1 would have eliminated the expeditious return requirement.

⁴² Deletion of this example was consistent with the proposed regulatory provisions that exempted a returning bank from the expeditious return requirements if it did not have arrangements in place to return the check electronically (See discussion of § 229.32(c) below).

returning banks, with a two-day expeditious return test, for the reasons discussed above in this section-by-section analysis with respect to the two-day expeditious return test for paying banks. The Board has also adopted the proposed commentary with modifications to clarify that a returning bank that agrees to handle a returned check (as described in the commentary to § 229.32(a)) is subject to the expeditious return requirement for the reasons discussed below in § 229.33(a) of this section-by-section analysis.

c. Section 229.32(c)—Exceptions to Expeditious Return of Checks by Returning Bank

Alternative 1 of proposed § 229.32(c) would eliminate the expeditious return requirement, and thus eliminate these exceptions to that requirement. Alternative 2 of proposed § 229.32(c) included exceptions to the expeditious return requirement similar to those set forth for paying banks under Alternative 2 of proposed § 229.31(c): The expeditious return requirement would not apply if (1) the returning bank does not have an agreement to send electronic returned checks directly or indirectly to the depository bank, and the returning bank has not otherwise agreed to handle the returned check; (2) the check is being returned to a depository bank that is not subject to subpart B of Regulation CC; or (3) the check is being returned to an unidentifiable depository bank.

No agreements for direct or indirect electronic return. Alternative 2 of proposed § 229.32(c) would not subject a returning bank to the expeditious return requirement if the returning bank did not have an agreement to send electronic returned checks to the depository bank or to a returning bank that has an agreement to send electronic returned checks to the depository bank, and the returning bank has not otherwise agreed to handle the returned check expeditiously. As with paying banks under Alternative 2 of proposed § 229.31(c), a returning bank would be subject to the expeditious return requirement if it had the necessary agreements to send electronic returned checks, but chose to send paper returned checks. The proposed commentary to Alternative 2 of proposed § 229.32(c) provided an example of when a returning bank would not be subject to the expeditious return requirement because it had no agreement to send electronic returned checks directly or indirectly to the depository bank.

Depository bank not subject to subpart B. Alternative 2 of proposed

§ 229.32(c) would provide an exception to a returning bank's expeditious return requirement for checks deposited into a depository bank that is not subject to subpart B of Regulation CC. The proposed commentary to Alternative 2 explained that a bank is not subject to subpart B when it does not maintain "accounts" and when it is not a "depository institution" within the meaning of the EFA Act.

Unidentifiable depository bank. The Board proposed under Alternative 2 to provide that a returning bank that receives a returned check for which the paying bank was unable to identify the depository bank would not be subject to the expeditious return requirement. Even though the returning bank may be able to identify the depository bank, it would be difficult for the returning bank to meet the two-day test because the paying bank likely would have sent the returned check as if it were not subject to the expeditious return requirement. A returning bank would still be required to use ordinary care when returning the item.⁴³

The Board did not receive any comments concerning Alternative 2 of proposed § 229.32(c). For the reasons stated in § 229.31(d) of this section-by-section analysis, the Board has adopted as its final rule Alternative 2 of proposed § 229.32(c) and the accompanying commentary, with clarifying revisions, setting out exceptions to the expeditious return of checks for returning banks with modifications to correspond to the exceptions for paying banks, including removal of the exception for returning banks that do not have agreements for direct or indirect electronic return. Because a returning bank that handles a returned check is subject to the expeditious return requirement, as described in § 229.32(b) of this section-by-section analysis, the Board has also adopted an exception to the expeditious return requirement for returning banks that handle a misrouted check pursuant to § 229.33(f).

d. Section 229.32(d)—Notice in Lieu of Return

The current notice in lieu of return requirements for returning banks are the same as for paying banks. The Board requested comment on changes to the notice-in-lieu provisions for returning banks in § 229.32(d) and the related commentary that parallel the proposed notice-in-lieu provisions for paying banks. The Board did not receive any comments on these provisions and has

adopted the changes to parallel those for paying banks discussed in § 229.31(f).

e. Section 229.32(e)—Settlement

In proposed § 229.32(e), the Board retained a returning bank's settlement obligation for returned checks as set forth in current § 229.31(c). In the proposed commentary to § 229.32(e), the Board made minor revisions to the current commentary to current § 229.31(c) to improve clarity. The Board did not receive any comments on proposed § 229.32(e) or the proposed related commentary and has adopted the revisions as proposed.

f. Section 229.32(f)—Charges

In proposed § 229.32(f) the Board retained the current § 229.31(d), which provides that a returning bank may impose a charge on a bank sending a returned check for handling the returned check. The Board did not receive any comments on proposed § 229.32(f). The Board has retained current § 229.31(d) and redesignated it as § 229.32(f) as proposed.

g. Section 229.32(g)—Reliance on Routing Number

Current § 229.31(g) provides that a returning bank may return a returned check based on any routing number designating the depository bank appearing on the returned check in the depository bank's indorsement or in magnetic ink on a qualified returned check. The Board proposed to redesignate this provision as § 229.32(g). The Board also proposed to add to the current commentary a statement that a returning bank, when returning a check, may rely on routing numbers in the electronic returned check received by the returning bank pursuant to an agreement. This proposed revision is similar to that described in connection with the proposed commentary to proposed § 229.31(i), above. The Board did not receive any comments on proposed § 229.32(g) or the proposed related commentary and has adopted them as proposed.

4. Section 229.33—Depository Bank's Responsibility for Returned Checks and Notices of Nonpayment

The Board proposed to consolidate the regulation's provisions related to a depository bank's responsibility for returned checks and notices of nonpayment in one section.

a. Section 229.33(a)—Right to Assert Claim

As discussed above, the Board proposed two alternatives with respect to the expeditious return requirement.

⁴³ UCC 4–202.

Alternative 1 would eliminate the expeditious return requirement, and Alternative 2 would retain the expeditious return requirement so long as the paying bank had agreements in place to send an electronic return, directly or indirectly, to the depository bank. Some commenters stated that Alternative 1 had the potential to slow check returns and provided a lack of incentives for depository banks that currently accept paper checks to accept electronic returns. Other commenters stated that, under Alternative 2, it may be difficult for a paying bank to know whether its returning bank had an electronic return arrangement with a particular depository bank and thus whether it was subject to the expeditious return requirement. These commenters also raised the concern that a paying bank could avoid being subject to the expeditious return requirement by not having an agreement with either a depository bank or returning bank to accept electronic returns. In light of the concerns raised with both Alternative 1 and Alternative 2, the Board has adopted a final rule that imposes an expeditious return requirement for all paying and returning banks (discussed above under §§ 229.30 and 229.31).

Rather than basing the applicability of the expeditious return requirement on the electronic return arrangements established by the paying and returning banks with the depository bank, the final rule places limits on a depository bank's ability to bring a claim for a violation of an expeditious return requirement. Section 229.33(a)(1) of the final rule states that a paying bank or returning bank may be liable to a depository bank under § 229.38 for failing to return a check in an expeditious manner only if the depository bank has arrangements in place such that the paying bank or returning bank could return a returned check to the depository bank electronically, directly or indirectly, by commercially reasonable means. Section 229.33(a)(2) of the final rule states that the depository bank has the burden of establishing that its arrangements for electronic returns meet the "commercially reasonable" standard.

The Board believes that this provision, in combination with the two-day expeditious return requirement for all checks as well as the notice of nonpayment requirement for returned checks over \$5,000, provides an effective incentive for electronic returns. Specifically, the Board believes that under the final rule, depository banks will have appropriate incentives to accept electronic returns in order to retain their ability to bring claims for

violations of an expeditious return requirement, and paying banks and returning banks will have incentives to send returns electronically in order to avoid the likelihood that they would fail to meet their expeditious return obligations using paper returns.

The "commercially reasonable means" requirement is intended to prevent a depository bank from establishing electronic return arrangements that are very limited in scope or that provide unreasonable barriers to presentment such that, in practice, the depository bank would accept only a small number of its returns electronically. The Board believes the commercially reasonable means standard allows for case-by-case flexibility and can change over time to reflect market practices.

b. Section 229.33(b)—Acceptance of Electronic Returned Checks and Electronic Notices of Nonpayment

In Alternative 1, the Board proposed to provide that a depository bank's agreement with the transferor bank governs its acceptance of electronic returned checks and electronic written notices of nonpayment.⁴⁴ The transferor bank may be either the paying bank or a returning bank. Alternative 2 was identical to Alternative 1, except references to notices of nonpayment were omitted. The proposed commentary clarified the operation of the provision and described some of the details that might be specified in such an agreement. The Board did not receive any comments on the proposal. The Board has adopted Alternative 1 and the related commentary as proposed, now designated as § 229.33(b).

c. Section 229.33(c)—Acceptance of Paper Returned Checks and Paper Notices of Nonpayment

Current § 229.32(a) specifies the locations where a depository bank must accept returned checks and notices of nonpayment.⁴⁵ The Board proposed to specify that the provisions of current § 229.32(a) would apply to paper returned checks and paper notices of nonpayment only, as the acceptance of electronic returns and notices would be covered by an agreement between the banks. The Board also proposed to eliminate the references to situations in which the address in the depository bank's indorsement is not in the same

⁴⁴ An agreement is not required for a paying bank to provide an oral notice of nonpayment, *i.e.*, a notice provided over the telephone as discussed in § 229.33(c) below.

⁴⁵ Current § 229.33(c) provides that § 229.32(a) governs where a depository bank must accept written notices of nonpayment.

check-processing region as the address associated with the routing number in its indorsement. Because there is a now single national check-processing region, these situations no longer exist. The Board did not receive any comments on the proposed regulatory text and has adopted it as proposed, now designated as § 229.33(c). The Board has adopted the proposed corresponding commentary with one revision, which removes as redundant the statement that banks may vary by agreement the location at which notices are received.

d. Section 229.33(d)—Acceptance of Oral Notices of Nonpayment

Current § 229.33(c) requires a depository bank to accept oral notices of nonpayment (1) either at the telephone or telegraph number of its return-check unit indicated in the indorsement or, if no such number appears in the indorsement or if the number is illegible, at the general purpose number of its head office or the branch indicated in the indorsement; and (2) at any other number held out by the bank for receipt of notice of nonpayment.

Proposed Alternative 1 provided that a depository bank must accept oral notices of nonpayment (1) at the telephone number indicated in the indorsement, rather than solely the telephone number of the return-check unit indicated in the indorsement and (2) at any other number held out by the bank for receipt of notice of nonpayment.⁴⁶ (Proposed Alternative 2 eliminated the notice of nonpayment provision.) The Board also requested comment on whether a depository bank that has agreed to accept written notices of nonpayment electronically should be required to also accept oral notices of nonpayment. The Board did not receive any comments on Alternative 1 and has adopted it and the accompanying commentary as proposed, now designated as § 229.33(d).

e. Section 229.33(e)—Payment

Current § 229.32(b) sets forth the depository bank's duties to settle with a paying bank or returning bank for a returned check. The Board proposed to make minor non-substantive amendments to this provision. The Board did not receive any comments on this provision and has adopted it, and the accompanying commentary, as proposed, now designated as § 229.33(e).

⁴⁶ Similar to the notice of nonpayment provisions for paying banks, the Board proposed to delete references in the depository bank notice of nonpayment provisions to using the telegraph as a means of accepting notices.

f. Section 229.33(f)—Misrouted Returned Checks and Written Notices of Nonpayment

The Board proposed to modify slightly current § 229.32(c), which requires a bank that receives a misrouted returned check or written notice of nonpayment on the basis that it is the depository bank, but determines that it is not the depository bank, to send the returned check or notice to the depository bank directly, to a returning bank agreeing to handle the returned check or notice expeditiously, or back to the bank from which it received the misrouted return or notice. Consistent with the Board's proposed changes to the expeditious return requirements of both Alternative 1 and Alternative 2, the Board also proposed to remove the requirement that a returning bank agree to handle the returned check expeditiously. The Board did not receive any comments on this provision, and has adopted it as proposed, now designated as § 229.33(f).⁴⁷

g. Section 229.33(g)—Charges

The proposal set forth without change the provisions of current § 229.32(d) prohibiting a depository bank from imposing charges for accepting and paying checks being returned to it. The Board did not receive any comments on this provision, and it remains unchanged in the final rule, now designated as § 229.33(g).

h. Section 229.33(h)—Notification to Customer

Current § 229.33(d) requires a depository bank to notify its customer when it receives a returned check or notice of nonpayment related to that customer's account. The Board proposed to amend this provision to also require that the depository bank notify its customer when the bank receives notice of recovery under § 229.35(b) (liability of bank handling a check).⁴⁸

Both proposed Alternatives 1 and 2 would add this requirement, although Alternative 2 did not retain the reference to a notice of nonpayment. The Board did not receive any comments on the proposed provision or related commentary. In its final rule, the Board has adopted Alternative 1 and the related commentary as proposed, now designated as § 229.33(h).

⁴⁷ As described above in § 229.32(c) of this section-by-section analysis, the Board has adopted an exception to the expeditious return requirement of § 229.32(b) for returning banks that handle misrouted returned checks pursuant to this section.

⁴⁸ The notice of recovery customer notification provision is currently set forth in the commentary to § 229.33(d).

i. Section 229.33(i)—Depository Bank Without Accounts

Current § 229.33(e) provides that the notice of nonpayment requirement does not apply to checks deposited in a depository bank that does not maintain accounts (as defined in Regulation CC). The Board did not propose any changes nor receive any comments on this provision. It remains unchanged in the final rule, designated as § 229.33(i).

5. Section 229.34—Warranties and Indemnities

a. Section 229.34(a)—Warranties With Respect to Electronic Checks and Electronic Returned Checks

Proposed § 229.30(a), adopted in the final rule, provides that electronic checks and electronic returned checks are subject to the provisions of subpart C as if they were checks. Accordingly, the Board's proposed § 229.34 applied all of the warranties and indemnities in that section to a bank that handles an electronic check or electronic returned check. In addition to those warranties, the Board proposed that new warranties be made with respect to electronic checks and electronic returned checks.

Content of warranties. The Board proposed to add new warranties that would be made by a bank that transfers or presents an electronic check or electronic returned check and receives settlement or other consideration for it. The Board proposed that the bank would warrant that the electronic image accurately represents all of the information from the original check as of the time the original check was truncated, that the electronic information contains an accurate record of all the MICR line information required for a substitute check under the regulation's substitute check definition,⁴⁹ and the amount. The bank would also warrant that no person will receive transfer, presentment, or return of, or otherwise be charged for, an electronic check or electronic returned check, the original check, a substitute check, or a paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid. These warranties are similar to the warranties provided in § 229.52 for transfers of substitute checks and would result in a seamless warranty chain regardless of whether a check is in the form of an electronic check or a substitute check.

The Board proposed to clarify in the commentary that the warranties in § 229.34(a) are in addition to any

warranties a bank makes under § 229.34(b) through (e) with respect to an electronic check or electronic returned check. Furthermore, the Board proposed to clarify in the commentary how the new warranties in § 229.34(a)(1) relate to the creation of substitute checks and the substitute check warranties. The Board also proposed to clarify in the commentary that the sending bank and receiving bank may vary the new warranties by agreement with respect to the parties that are bound by the agreement.

Parties to whom the warranties are made. The Board proposed to provide that these warranties would flow, in the case of electronic checks sent for forward collection, to the transferee bank, any subsequent collecting bank, the paying bank, and the drawer of the check. The Board proposed to provide that, in the case of an electronic returned check, the warranties would flow to the transferee returning bank, any subsequent returning bank, the depository bank, and the owner of a returned check. These provisions are consistent with the flow of the substitute check warranties in § 229.52.

Most commenters agreed with the proposal to extend warranties to electronic checks and electronic returned checks. Four commenters expressed concern that the proposal could result in some increased risk to banks because electronic checks and electronic returned checks are currently governed by agreements between banks and requested, without further elaboration, that the Board limit these risks. Some commenters disagreed with the portion of the proposal that extended the warranties to the drawer of the check and the owner of the returned check because it would complicate the interbank warranty process, complicate the appropriate resolution of the dispute, and potentially expose banks other than the account holding bank to direct liability.

In the final rule, the Board has adopted § 229.34(a) and the accompanying commentary as proposed. The Board acknowledges that electronic checks and electronic returned checks are currently governed by agreements between banks and notes that, as stated in the commentary, the warranties in § 229.34(a) can be varied by agreement by the sending bank and receiving bank. The Board believes that extending the warranties to the drawer of the check and the owner of the returned check is important to maintain a consistent chain of Check-21-like warranties regardless of whether the check is in the form of an electronic check or a substitute check. The final

⁴⁹ 12 CFR 229.2(aaa).

rule provides protection for drawers and owners from harm that is usually beyond their control, such as harm resulting from illegible images or incorrect MICR lines.

b. Section 229.34(b)—Transfer and Presentment Warranties With Respect to a Remotely Created Check

Under current § 229.34(d), a bank that transfers or presents a remotely created check and receives settlement or other consideration warrants to the transferee bank, any subsequent collecting bank, and the paying bank that the person on whose account the remotely created check is drawn authorized the issuance of the check in the amount stated on the check and to the payee stated on the check. The Board proposed to retain this provision without substantive change. The Board also proposed to revise the commentary to conform to the Federal Trade Commission's proposed changes to its Telemarketing Sales Rule concerning remotely created checks.⁵⁰ The Board did not receive any comments with respect to this section and has adopted it, now designated as § 229.34(b), with revisions to the commentary to simplify the discussion of the Federal Trade Commission's final Telemarketing Sales Rule concerning remotely created checks by providing a cross-reference.⁵¹ The Board has also added an introduction to the commentary for § 229.34 to clarify that the warranties apply to paper checks and electronic checks.

c. Section 229.34(c)—Settlement Amount, Encoding, and Offset Warranties

Current § 229.34(c) contains additional warranties provided by banks related to the settlement amount requested, the encoding on the check, and certain settlement offsets. Under the proposed rule, the Board would have retained these provisions, and they would be applicable to electronic checks and electronic returned checks by operation of § 229.30(a), which provides that electronic checks and electronic returned checks are subject to the provisions of subpart C as if they were checks or returned checks, unless the subpart provides otherwise. In addition, the Board proposed to revise slightly the encoding warranty, which currently provides a warranty that the

information encoded after issue in magnetic ink on the check or returned check is correct, and that the information encoded after issue includes information placed in the MICR line of a substitute check that represents that check or returned check. The Board proposed to revise the wording of that warranty to provide (1) that a bank warrants that the information encoded after issue is "accurate," instead of "correct" and (2) that the information encoded after issue regarding the check or returned check means any information that could be encoded in the MICR line of a paper check. The Board did not receive any comments with respect to this section and has adopted it as proposed, now designated as § 229.34(c). The Board has also added an introduction to the commentary for § 229.34 to clarify that the warranties apply to paper checks and electronic checks.

d. Section 229.34(d)—Returned Check Warranties

Current § 229.34(a) contains warranties provided by paying banks and returning banks with respect to returned checks. Like the settlement and encoding warranties discussed above, the Board proposed to retain these returned check warranties and make them applicable to electronic returned checks by operation of § 229.30(a), which provides that electronic returned checks are subject to the provisions of subpart C as if they were checks or returned checks, unless the subpart provides otherwise. Under one of the current returned check warranties, the paying bank warrants that it returned the check by its return deadline under the UCC (or the UCC deadline as extended under Regulation CC), and the Board's Regulation J (12 CFR part 210), which governs the collection and return of checks through Federal Reserve Bank. The Board proposed to remove the reference to return deadlines specified in Regulation J. Any variation of this warranty for checks collected through the Federal Reserve Banks would be addressed in Regulation J and need not be specified in Regulation CC. The Board did not receive any comments with respect to this section and has adopted the section and its commentary, consistent with the proposal and the expeditious return requirements in Alternative 2, now designated as § 229.34(d). The Board has also added an introduction to the commentary for § 229.34 to clarify that the warranties apply to paper checks and electronic checks.

e. Section 229.34(e)—Notice of Nonpayment Warranties

Current § 229.34(b) contains warranties provided by the paying bank with respect to a notice of nonpayment to the transferee bank, any subsequent transferee bank, the depository bank, and the owner of the check. Under proposed Alternative 1, the requirement for notices of nonpayment would be retained, along with the notice of nonpayment warranties. Under one of the current notice of nonpayment warranties, the paying bank warrants that it returned or will return the check by its return deadline under the UCC (or the UCC deadline as extended under Regulation CC), and the Board's Regulation J (12 CFR part 210), which governs the collection and return of checks through Federal Reserve Bank. As was the case with the return warranties discussed above, the Board proposed to remove the reference to return deadlines specified in Regulation J; any variation of this warranty for checks collected through the Federal Reserve Banks would be addressed in Regulation J and need not be specified in Regulation CC.

Current Regulation CC also provides that the notice of nonpayment warranties do not apply with respect to checks drawn on a state or a unit of general local government that are not payable through or at a bank. State and local governments are not "paying banks" under the rule and checks drawn on state and local governments are explicitly excluded from the notice of nonpayment requirements under § 229.42.⁵² Similarly, the Treasury of the United States and the U.S. Postal Service are not "paying banks," and checks drawn on those entities are also excluded from the notice of nonpayment requirement under § 229.42. Accordingly, the Board proposed to explicitly state in the notice of nonpayment warranty section that those warranties are not made with respect to checks drawn on the Treasury of the United States or U.S. Postal Service money orders.

The Board did not receive any comments with respect to this section. As discussed above in § 229.31(c), the Board has adopted the notice of nonpayment requirement for returned checks over \$5,000. Accordingly, the Board is also adopting the notice of nonpayment warranties consistent with its proposal under Alternative 1, now designated as § 229.34(e). The Board has added an introduction to the commentary for § 229.34 to clarify that

⁵² See commentary to the definition of "paying bank" in § 229.2(z).

⁵⁰ The proposed rule is available on the FTC's Web site at <https://www.ftc.gov/policy/federal-register-notices/16-cfr-part-310-telemarketing-sales-rule-federal-register-notice>.

⁵¹ The final rule is available on the FTC's Web site at <https://www.ftc.gov/policy/federal-register-notices/16-cfr-part-310-telemarketing-sales-rule-final-rule-amendments>.

the warranties apply to paper checks and electronic checks.⁵³

f. Section 229.34(f)—Remote Deposit Capture Indemnity

The Board proposed a new indemnity to address the allocation of liability when a depository bank accepts deposit of a check through “remote deposit capture,” that is, when the depositor sends the bank electronic information about a check, such as a photographic image, which the bank uses to create an electronic check or substitute check for collection. The proposed indemnity would be provided by a bank that accepted a check via remote deposit capture to a bank that accepted the original check for deposit, in the event the bank that accepted the original check incurred a loss because the check had already been paid.

Under the proposal, the indemnity would be provided by a depository bank that (1) is a “truncating bank” under Regulation CC because it accepts deposit of an electronic image or other electronic information related to an original check, (2) does not receive the original check, (3) receives settlement or other consideration for an electronic check or substitute check related to the original check, and (4) does not receive the check returned unpaid. The proposed indemnity ran to a depository bank that accepts the original check for deposit for that depository bank’s losses due to the check having already been paid.

Thirty commenters addressed the proposed indemnity relating to remote deposit capture. Twenty-two commenters opposed the indemnity as proposed, believing that it would cause small institutions to stop offering remote deposit capture.⁵⁴ Of those, 10 commenters proposed offering an indemnity for remote deposit capture only when the bank does not mandate a restrictive indorsement that states the item is, for example, “for mobile deposit only at XYZ bank, date, and account number.” One commenter recommended shifting the liability only if the institution that accepted the paper check does not offer remote deposit capture. Some commenters requested clarification of how the warranty applies when a check is truncated by multiple banks.

⁵³ The Board has also corrected an error in the current commentary, which incorrectly used “return” instead of “does not return” in stating that “This paragraph imposes liability on a paying bank that gives notice of nonpayment and then subsequently returns the check.”

⁵⁴ One comment, received as part of the EGRPRA process, expressed similar concerns.

Six commenters, including a Federal Reserve Bank commenter and the group letter, supported the proposed provision, stating that it is reasonable to impose the loss on the truncating bank because it is best positioned to control the subsequent deposit of the paper check by its customer. Two commenters, including the group letter, suggested that the proposal include a time period within which the indemnified bank must make a claim. Three commenters, including the group letter, suggested that the Board include commentary on the process by which the indemnified bank must obtain information from the paying bank to identify the indemnifying bank. A few commenters, including the group letter, suggested that the Board clarify that the indemnity is not applicable when the loss is the result of an alteration of an item, or counterfeit item.

The Board finds that basing the indemnity on whether the depository bank that accepts the original check also offers remote deposit capture would not be an appropriate approach. The Board believes that the bank that accepts the original check should receive the indemnity, irrespective of whether that bank also offers remote deposit capture. As noted by many commenters, the bank that accepts a check via remote deposit capture is in the best position to address the actions of its own customer and to guard against the subsequent deposit of the paper check. The Board believes that this indemnity provides an appropriate incentive for the bank providing remote deposit capture services to take steps to minimize potential fraudulent deposits. The Board also believes that § 229.38(g) provides sufficient clarity that actions under this section must be brought within one year after the date of the occurrence of the violation involved.

Based on comments received, however, the Board has added an exception to the indemnity, and associated commentary, which would prevent a bank from making an indemnity claim if it accepted the original check containing a restrictive indorsement inconsistent with the means of deposit, such as “for mobile deposit only.” The Board believes that providing this exception may reduce accidental double deposits and may provide incentives for banks that receive remote deposit capture deposits to take steps to minimize intentionally fraudulent deposits.

The Board believes that the details of how to ascertain the identity of the indemnifying bank are best left to the banks involved. The Board will continue to monitor the use of this

indemnity and may consider further action should conditions warrant. In the final rule and corresponding commentary, the Board is changing this section’s title from the proposed “Truncating Bank Indemnity” to “Remote Deposit Capture Indemnity” and has designated this section as § 229.34(f).⁵⁵

g. Section 229.34(g)—Indemnities With Respect to Electronically-Created Items

As a practical matter, a bank receiving an electronic image generally cannot distinguish an image that is derived from a paper check from an electronically-created item. Nonetheless, the bank receiving the electronically-created item often handles the electronically-created image as if it were derived from a paper check. Accordingly, the Board proposed a new requirement for a bank that transfers an electronic image or electronic information that is not derived from a paper check to indemnify the transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against any loss, claim, or damage that results from the fact that the image or information was not derived from a paper check.

The proposed indemnity would protect a bank that receives an electronically-created item from a sending bank against any loss or damage that results from the fact that there was no original check corresponding to the item that the sending bank transferred. The indemnity would not flow to the paying bank’s customer, payee, or depository bank of the item. The Board reasoned that the payee and the depository bank are in the best position to know whether an item is electronically created and to prevent the item from entering the check-collection system. Additionally, for items electronically created by the paying bank’s customer, the customer introduces the item into the check collection system.⁵⁶ Therefore, the Board did not believe it would be

⁵⁵ The final rule provides that the bank providing the indemnity accepts a deposit of “an electronic image or other electronic information” related to an original check, rather than an “electronic check.” This revision reflects the fact that the data deposited by the indemnifying bank’s customer may not meet all the requirements of the definition of “electronic check,” such as not including the identity of the depository bank and the truncating bank, and the indemnifying bank may need to format the data as an electronic check or a substitute check before sending it for collection.

⁵⁶ For an electronically-created item not created by the paying bank’s customer that results in an unauthorized debit, the paying bank’s customer should normally be made whole by the paying bank in accordance with UCC 4–401 or Regulation E (12 CFR part 1005), as applicable.

appropriate for subsequent banks handling the item to indemnify those parties for losses. The Board also proposed examples of the indemnity in the commentary.

Eighteen commenters, including the group letter, addressed the indemnities relating to electronically-created items. All commenters, except one, agreed with providing some form of indemnity for electronically-created items. Of these commenters, some agreed with the proposal without recommending any changes, some agreed and requested that the Board clarify the indemnities without further specification, and some agreed and requested that the indemnities be combined with some form of warranty. The commenters that proposed the indemnities be combined with warranties, including the group letter and one Federal Reserve Bank commenter, suggested providing either the same warranties as for checks, the same warranties as for substitute checks, or a combination of the two. The commenter that opposed the proposed indemnities stated that electronically-created items present inherent risks, and that banks with a substantial volume of these transactions can adequately mitigate the risk without mandating indemnity requirements for other banks that are not similarly situated.

Three commenters, including the group letter, requested that the Board clarify that a paying bank may bring a claim under the proposed indemnity to recover a paying bank's losses arising from its own Regulation E noncompliance. The group letter also suggested that the Board clarify that an electronically-created "remotely created check" would be covered by the proposed indemnities and provide more detailed commentary regarding the application of the indemnity to an unauthorized electronically-created item.

In the final rule, the Board has adopted two additional indemnities along with the previously proposed indemnity for electronically-created items. The newly adopted indemnities are for losses caused by the fact that (1) the person on whose account the electronically-created item is drawn did not authorize the issuance of the item in the amount stated on the item or to the payee stated on the item, and (2) a person receives a transfer, presentment, or return of, or otherwise is charged for an electronically-created item such that the person is asked to make payment based on an item or check it has already paid. Each bank that transfers or presents an electronically-created item and receives settlement indemnifies the transferee bank, any subsequent

collecting bank, the paying bank, and any subsequent returning bank. The transferees protected by these additional indemnities will have a claim against the indemnifying bank for damages pursuant to § 229.34(i) regardless of whether the damages would have occurred if the item transferred had been derived from a paper check. The Board believes that these additional indemnities provide a basic level of protection from unauthorized items and duplicate presentment, which are common problems associated with electronically-created items. The Board is adopting these protections as indemnities, rather than warranties as some commenters proposed, as there would not likely be a difference in the damage calculation as between an indemnity and a warranty, and the rule permits a comparative negligence claim for indemnities, which may be appropriate in some cases for these items. Alongside the new indemnities, the Board has adopted the indemnity with respect to electronically-created items as proposed. The provisions on indemnities for electronically-created items are designated as § 229.34(g) in the final rule.

The Board believes that the commentary and corresponding examples included with the newly defined term "electronically-created item" in § 229.2(hhh) provide sufficient clarity that an electronically-created "remotely created check" would meet the definition and therefore would also be covered by § 229.2(g). The Board has clarified in the commentary that a paying bank may bring a claim under the proposed indemnity to recover a paying bank's losses arising from Regulation E non-compliance. The Board has also revised the commentary and examples to provide additional clarity with respect to unauthorized items and the application of the indemnities to depository banks.

h. Section 229.34(h)—Damages for Breach of Warranties

The Board proposed no substantive changes to current § 229.34(e) (and related commentary) limiting the amount of damages for breach of the warranties set forth in § 229.34. The Board did not receive any comments with respect to this provision, and it remains unchanged in the final rule, designated as § 229.34(h), except to correct cross-references in the commentary.

i. Section 229.34(i)—Indemnity Amounts

The Board proposed a new provision, and accompanying commentary, to

specify the maximum amounts of the new proposed indemnities for electronically-created items and remote deposit capture. Specifically, the Board proposed to provide that the indemnity amount not exceed the sum of the amount of the loss, up to the amount of the settlement or other consideration received by the indemnifying bank, and interest and expenses (including costs, reasonable attorney's fees and other expenses of representation).

In addition, the Board proposed to subject the indemnities for electronically-created items and remote deposit capture to a comparative negligence standard by providing that the indemnity amount would be reduced by the portion of the indemnified bank's loss that is attributable to the indemnified bank's negligence or failure to act in good faith. The proposal also specified that the indemnity would not affect the rights of a person under the UCC or other applicable provisions of state or federal law.

One commenter, the group letter, stated that the Board should not allow the comparative negligence defense for the indemnities because it would complicate the resolution of claims by paying banks. Specifically, the group letter expressed concern that the truncating bank would raise a comparative negligence defense in order to improve its bargaining position. The group letter stated that the losses associated with electronically-created items and remote deposit capture should be placed on the bank that allowed it to enter the payment system and that the paying bank had no control over the creation of the item.

The Board does not believe it is appropriate to allow a bank that has been negligent or acted in bad faith to obtain an indemnity. Moreover, reducing the amount of the indemnity based on the negligence or failure to act in good faith on the part of the indemnified party is consistent with the approach taken in the Check 21 Act. Accordingly, the Board has adopted proposed § 229.34(i) with the addition of commentary clarifying that an indemnified bank may not recover more than the indemnity amount described.

j. Section 229.34(j)—Tender of Defense

Current § 229.34(f) provides for the tender of defense by a bank that is sued for a breach of a Regulation CC warranty. The regulation permits tender of defense to a prior bank in the collection or return chain and sets out notice requirements for the tender. The Board proposed a minor change to this provision to broaden its application to

indemnities as well as warranties. The Board did not receive any comments with respect to this provision and has adopted it as proposed, now designated as § 229.34(j).

k. Section 229.34(k)—Notice of Claim

Current § 229.34(g) provides that a notice of a warranty claim must be provided to the warranting bank within 30 days after the claimant has reason to know of the warranty breach and the identity of the warranting bank, otherwise the warranting bank is discharged to the extent of any loss caused by the delay in giving notice. The Board proposed to expand this provision of the rule (and its accompanying commentary) to cover notices of indemnity claims as well as warranty claims. The Board did not receive any comments with respect to this section and has adopted the provisions substantively as proposed, with minor editorial changes, now designated as § 229.34(k).

6. Section 229.35—Indorsements

Regulation CC currently requires a bank (other than the paying bank) that handles a check or returned check to indorse the check in a manner that permits a person to interpret the indorsement in accordance with the indorsement standard set forth in Appendix D to the regulation. Current Appendix D pertains to indorsements that banks apply to original checks and substitute checks.

The Board proposed to eliminate Appendix D and instead to incorporate into the regulation (and accompanying commentary) the industry indorsement standards for paper checks, substitute checks, and electronic checks, specifically American National Standard (ANS) Specifications for Physical Check Endorsements, X9.100–111 for a paper checks other than substitute checks; ANS Specifications for an Image Replacement Document, X9.100–140 for substitute checks; and ANS Specifications for Electronic Exchange of Check and Image Data—Domestic, X9.100–187 for electronic checks. The proposal did not amend § 229.35(b) or (c).

The Board proposed to state in the commentary that ANS X9.100–187 is an industry standard for handling checks electronically, but that multiple electronic check standards may exist that would enable a receiving bank to create a substitute check, and that the parties may agree to send and receive checks as electronic images and information that conform to a different standard.

The Board also proposed to include the portions of the current commentary that discuss allocation of liability in the commentary to the liability section (§ 229.38). The Board also proposed to move those portions of the commentary that discuss the obligations of banks that create a substitute check (“reconverting banks”) into the commentary to § 229.51(b), which sets out requirements for reconverting banks. The Board proposed to make clarifying changes throughout the proposed commentary to § 229.35. For example, in paragraph 5 of the commentary to § 229.35(b), the Board proposed to clarify the regulation’s use of the term “final settlement.”

Two commenters addressed the Board’s proposal to eliminate Appendix D. One commenter, the group letter, recommended that the Board retain a version of Appendix D in order to clearly establish the responsibilities of banks with respect to indorsements. Specifically, the group letter stated that there have been growing problems in the check industry with banks not complying with the indorsement requirements in Appendix D. The group letter expressed concern that if Regulation CC simply incorporates by reference the check industry standards for the bank indorsement requirements, the problems of noncompliance would worsen. Another commenter agreed with the Board that eliminating the indorsement requirement in Appendix D would have little to no effect on the collection or return process.

The Board has adopted the proposed revisions to § 229.35 and the accompanying commentary with minor technical revisions to clarify industry standards referenced and to conform to the Board’s retention of the expeditious return requirements, as described above. The Board has also removed references to carbon bands, as discussed below in § 229.38(d). The Board believes that banks’ processes related to substitute checks and applying indorsements and identifications electronically have become well-established since 2004, when the current indorsement standard in Appendix D became effective. Furthermore, industry standards set forth the specifics for how banks should indorse, or identify themselves. In the absence of any evidence that eliminating the indorsement requirement in Appendix D will result in a significant increase in noncompliance, the Board has determined that incorporating by reference the substance of the indorsement standards in § 229.35(a) is sufficient.

7. Section 229.36—Presentment and Issuance of Checks

a. Section 229.36(a)—Receipt of Electronic Checks

Current § 229.36(a) provides that a check payable at or through a paying bank is considered to be drawn on that bank for purposes of the expeditious return and notice of nonpayment requirements of Regulation CC. As discussed above, the Board proposed to move this provision to § 229.31, which contains other provisions related to paying banks. The Board proposed to add a new provision in § 229.36(a) to provide that a paying bank’s receipt of an electronic check is governed by the paying bank’s agreement with the presenting bank. The Board proposed to state in the related commentary that the terms of the agreement are determined by the parties and may include, for example, the electronic address or electronic receipt point at which the paying bank agrees to accept electronic checks, as well as when presentment occurs. The Board did not receive any comments with respect to this section and has adopted § 229.36(a) and the accompanying commentary with minor editorial changes.

b. Section 229.36(b)—Receipt of Paper Checks

Current § 229.36(b) describes the locations at which a check is considered received by the paying bank. The Board proposed amendments to this provision to specify that it applies to locations for accepting checks in paper form only, and to make non-substantive editorial changes. The Board also proposed revisions to the commentary to clarify how the provision applies to substitute checks and to delete the statement about the tradeoff between including an address on a check, versus simply stating the name of the bank to encourage acceptance outside a bank’s local area, in light of the elimination of the distinction between local and nonlocal checks.

In addition, the Board proposed a new provision in the regulation to permit a bank to require that checks presented to it as a paying bank be separated from returned checks. This provision mirrors a similar provision in § 229.33(c)(2) that permits a depository bank to require that returned checks be separated from forward-collection checks.

The Board did not receive any comments with respect to this section and has adopted § 229.36(b) and accompanying commentary with minor technical changes for clarity.

c. Section 229.36(c)—Liability of Bank During Forward Collection

Section 229.36(d) of Regulation CC currently provides that settlement between banks for the forward collection of a check are final when made, and sets out the chain of liability during forward collection. The Board did not propose any changes to this section, and it remains unchanged in the final rule, redesignated as § 229.36(c).

e. Section 229.36(d)—Same-Day Settlement

Section 229.36(f) of Regulation CC currently requires a paying bank to provide same-day settlement for checks presented in accordance with reasonable delivery requirements established by the paying bank and presented at a location designated by the paying bank by 8 a.m. (local time of the paying bank) on a business day.⁵⁷ The Board proposed to retain, without substantive change, the current same-day settlement provisions and to clarify that the provisions apply only to presentments of checks in paper form. Electronic check presentment would continue to be governed by the paying bank's agreement with the presenting bank. The Board also proposed to remove the requirement that a paying bank's designated location must be in a check-processing region consistent with the routing number on the check. As there is now only one national check-processing region, this provision is obsolete.

Seventeen commenters, including the group letter, addressed same-day settlement. The majority of commenters agreed with the retention of the same-day settlement rule, stating the terms of electronic presentment are already effectively governed by agreements between banks. These commenters also expressed concern that an electronic same-day settlement rule would require a bank to manage multiple electronic exchange agreements.

Four commenters supported the creation of an electronic same-day settlement rule.⁵⁸ These commenters stated that in today's mostly electronic environment, the current paper same-day settlement rule is no longer effective at addressing the competitive advantages the Federal Reserve Banks have compared to the private sector

⁵⁷ A paying bank may not charge presentment fees for checks—for example, by settling for less than the full amount of the checks—that are presented in accordance with same-day settlement requirements.

⁵⁸ One comment, received as part of the EGRPRA process, similarly supported an electronic same-day settlement rule.

correspondent banks when presenting and settling checks to paying banks. Four commenters suggested that the Board sunset the paper same-day settlement rule altogether.

In the final rule, the Board has retained, without substantive change, the current same-day settlement provisions. The Board agrees with the majority of commenters that the terms of electronic presentment can be determined by banks' agreements, as they are under current industry practice. This is consistent with the approach generally taken elsewhere with respect to electronic checks. The Board believes that the paper same-day settlement rule remains relevant, even though the nation's check collection system is now virtually all-electronic, because of the negotiating leverage it provides presenting banks in obtaining electronic presentment agreements with paying banks.⁵⁹

The Board has not adopted an electronic same-day settlement rule at this time. In response to the current proposal and the Board's 2011 proposal, many commenters voiced significant policy and operational concerns with the application of the same-day settlement rule to electronic checks. Moreover, in the absence of general industry standards, an electronic same-day settlement rule would need to address the implications of a paying bank communication or technical failure and prescribe technical specifications, such as communication protocols and security requirements.⁶⁰ Given the lack of industry consensus supporting an electronic same-day settlement rule and the practical challenges of crafting such a rule, the Board does not believe that the same-day settlement rule should be extended to cover electronic presentment at this time, but remains open to considering regulatory changes in the future that are broadly supported by the industry and foster the efficiency of the check collection system.

For these reasons, the Board has adopted § 229.36(f) and the

⁵⁹ Some commenters have expressed concerns that private-sector presenting banks, unlike the Reserve Banks, have not been able to obtain electronic presentment agreements with a broad range of paying banks. As described in the Board's competitive impact analysis below, the Board believes a correspondent bank that decides to present checks to a paying bank irrespective of whether the bank agrees to electronic presentment, like the Reserve Banks do, should also be able to obtain such electronic presentment agreements.

⁶⁰ For example, an electronic same-day settlement rule may need to address circumstances in which a paying bank experiences a system failure that prevents the presenting bank from transmitting the electronic checks to the paying bank by the presentment deadline.

accompanying commentary, redesignated as § 229.36(d), with minor editorial changes for clarity and to conform to the Board's retention of the expeditious return and notice of nonpayment requirements, as described above.

d. Section 229.36(e)—Issuance of Payable-Through Checks

Current § 229.36(e) contains requirements for information that must appear on payable-through checks to enable depository banks to identify those checks as local or nonlocal. As there is now a single national check-processing region and all checks are local, these requirements are no longer necessary. The Board proposed to eliminate this subsection and its accompanying commentary. The Board did not receive any comments with respect to this section and is removing current § 229.36(e) and its accompanying commentary as proposed.

8. Section 229.37—Variation by Agreement

Regulation CC currently permits parties to vary by agreement the effect of the provisions in subpart C, and the commentary provides examples of situations where variation by agreement is permissible. The Board proposed to revise the examples of permissible variations by agreement listed in the commentary to this section if the Board were to eliminate either the expeditious return requirement or the notice of nonpayment requirement in its final rule. The Board also requested comment on the prevalence of a practice that involved a paying bank debiting its customer's account and partially settling with the presenting bank upon receipt of electronic information related to a check (prior to the actual presentment of an electronic image of the check) and whether such a practice should be included as an example of an impermissible variation by agreement.

The Board received three comments, including the group letter, on § 229.37. Two commenters, including the group letter, supported the Board's variation by agreement proposal and stated that the Board should not prohibit or limit the ability of banks to vary by agreement any of the provisions of subpart C in regards to electronic exchange relationships. Two commenters, including the group letter, stated that they were not aware of banks engaging in the practice that involved receiving electronic information with the check image to be delivered later. One commenter recommended that the warranty in proposed § 229.34(a)(1)(ii)—

the warranty on duplicate presentment with respect to electronic checks and electronic returned checks—should not be able to be varied by agreement without further elaboration.

Because commenters stated that they were not aware of a practice that involves receiving electronic information with the check image to be delivered later, the Board did not adopt any revisions addressing such practices. The Board believes that banks should be allowed to vary by agreement the warranty in § 229.34(a)(1)(ii) as they are ultimately in the best position to determine the specific warranties and indemnities. The Board has not modified the current regulation or commentary, except for minor technical changes to clarify example 9 (previously example 10) and removing example 7 from the commentary, to reflect that only one check processing region exists today.

9. Section 229.38—Liability

a. Section 229.38(a)—Standard of Care, Liability, Damages

Section 229.38(a) of current Regulation CC requires banks to exercise ordinary care and act in good faith in complying with the requirements of subpart C of the regulation and sets forth the measure of damages for non-compliance. The Board proposed to retain the current provisions of this section, except that under Alternative 2 references to notices of nonpayment in the regulation and the accompanying commentary would be deleted.

The Board did not receive comments on proposed § 229.38(a). As the final rule retains the requirement for notices of nonpayment, the Board has not amended § 229.38(a) or its accompanying commentary other than corrections to cross-references corresponding to redesignated sections of the final rule-text.

b. Section 229.38(b)—Paying Bank's Failure To Make Timely Return

Regulation CC currently provides that a paying bank that fails to comply with both the expeditious return requirement and its return deadline under the UCC, Regulation J, or Regulation CC will be liable for one or the other but not both. The Board proposed to remove this provision and its accompanying commentary under Alternative 1, which did not contain an expeditious return requirement.

The Board did not receive comments on proposed § 229.38(b). As the final rule retains an expeditious return requirement, the Board has not amended § 229.38(b) or its

accompanying commentary other than corrections to cross-references corresponding to redesignated sections of the final rule-text.

c. Section 229.38(c)—Comparative Negligence

Section 229.38(c) of current Regulation CC set forth a comparative negligence standard in the case where a person asserting a claim has not exercised ordinary care or acted in good faith in indorsing a check, accepting a returned check or notice of nonpayment, or otherwise. Under Alternative 2, the Board proposed to eliminate the references in the regulation and the commentary to notices of nonpayment. The Board did not receive comments on proposed § 229.38(c). As the final rule retains the requirement for notices of nonpayment, the Board has not amended § 229.38(c). The Board has revised the accompanying commentary to remove references and examples to carbon bands, and obscured or unreadable indorsements, as the Board recognizes that in a virtually all-electronic check collection and return environment such instances are exceedingly rare and unlikely to cause difficulty for paying banks in identifying the depository bank. In doing so, the Board does not intend to change the application of § 229.38(c) or the outcome of such scenarios in the unlikely event that they actually occur.

d. Section 229.38(d)—Responsibility for Certain Aspects of Checks

Section 229.38(d)(1) sets forth the liabilities of banks in the check collection chain for marks on the check that obscure indorsements on the check. Specifically, a paying bank is responsible for damages resulting from an illegible indorsement to the extent that the condition of the check when issued by the paying bank or its customer adversely affected the ability of a bank to indorse the check legibly. By contrast, the depository bank is liable to the extent the condition of the back of a check arising after issuance and prior to acceptance of the check by the depository bank adversely affects the ability of a bank to indorse the check legibly. The current commentary provides examples of these liabilities with multiple references to the indorsement standard in Appendix D.

The Board did not propose any substantive amendments to § 229.38(d), but did propose changes to the accompanying commentary. In accordance with the proposed changes to § 229.35 (and the proposed elimination of Appendix D), the Board

proposed to replace the references to Appendix D in the commentary with a specific reference to the appropriate industry standard. In addition, the Board proposed to move the substance of the discussion regarding liability for carbon band and similar marking on the back of a check from the commentary to § 229.35(a) to the commentary to § 229.38(d). The Board requested comment on whether its proposed revisions clarified liability for unreadable indorsements, as well as whether any checks still used carbon bands.

Section 229.38(d)(2) of Regulation CC currently makes drawee banks liable to the extent they issue payable-through checks that are payable through a bank located in a different check-processing region and that circumstance causes a delay in return. As there is now a single national check-processing region, this provision is obsolete, and the Board proposed to delete current § 229.38(d)(2) and its accompanying commentary.

One commenter, the group letter, stated that there is little or minimal usage of carbon bands on the back of checks and suggested that this text be deleted from the commentary. The Board has revised the accompanying commentary to remove references and examples to carbon bands and obscured or unreadable indorsements, as the Board recognizes that in a virtually all-electronic check collection and return environment such instances are exceedingly rare and unlikely to cause difficulty for paying banks in identifying the depository bank. In doing so, the Board does not intend to change the application of § 229.38(d) or the outcome of such scenarios in the unlikely event that they actually occur. The Board has adopted the changes to § 229.38(d) otherwise as proposed.

e. Sections 229.38(e)–(h)

The Board did not propose changes to § 229.38(e) through (h) or the accompanying commentary. Those sections address circumstances where the time for bringing an action may be extended, clarify that the civil liability provisions of subpart B and the Act do not apply to subpart C, provide for jurisdiction in U.S. District Courts, and permit reliance on Board rulings. Sections 229.38(e) through (h) and the accompanying commentary remain unchanged in the Board's final rule.

10. Section 229.39—Insolvency of Bank

Current § 229.39 of Regulation CC addresses what happens when a paying bank, collecting bank, returning bank, or depository bank suspends payments when a check is in the process of being

collected or returned. Current § 229.39(a) requires a receiver, trustee, or agent in charge of a closed bank to return a check to the transferor bank or customer that transferred the check if the check or returned check (1) is in, or comes into, the possession of the paying bank, collecting bank, depository bank, or returning bank that suspends payment and (2) is not paid. This provision is similar to UCC 4–216(a).

Current § 229.39(b) and (c) provide banks with “preferred” claims against a paying bank, collecting bank, returning bank, or depository bank with respect to checks or returned checks that are not returned by the receiver, trustee, or agent in charge of a closed bank. Currently, a bank that is prior to the paying bank in the collection chain has a claim against a paying bank that has “finally paid” (that is, has no legal right to return) the check, but suspends payment without making a settlement for the check that is or becomes final. Similarly, a bank that is prior to the depository bank in the return chain has a claim against a depository bank that has become obligated to pay the returned check. Regulation CC currently provides claims to banks in the collection or return chain that have not received settlement that is or becomes final from a collecting bank, paying bank, or returning bank that itself had received final settlement prior to suspending payments. These sections are derived from UCC 4–216(b).

Although both Regulation CC and the UCC use the term “preferred claim,” the Official Comment to the UCC provides that purpose of UCC 4–216 “is not to confer upon banks, holders of items, or anyone else preferential positions in the event of bank failures over general depositors or any other creditors of the failed banks.” Rather, UCC 4–216 is intended to fix the cut-off point at which an item has progressed far enough in the collection or return process where it is preferable to permit the item to continue the remaining collection or return process, rather than return the item and reverse the associated entries.⁶¹

The Board proposed to amend and combine sections 229.39(b) and (c) (and make conforming changes to the accompanying commentary) to clarify that the claims do not give a bank a preferential position over depositors or other creditors of the failed banks. The Board did not intend these changes to be substantive, but rather to more clearly reflect the intent to adopt the same rule as the UCC. The Board did not receive comments on these

proposed clarifications. The Board has adopted these changes as proposed and made minor editorial changes to the corresponding commentary for clarity.

Current section 229.38(d) provides that a paying bank has a preferred claim against a presenting bank that breaches a settlement amount or encoding warranty. The Board intended that the claim be a preferred claim, putting the paying bank in the position of a secured creditor.⁶² The Board requested comment on whether it should retain this preferred claim.

Two commenters, including the group letter, commented on this provision and supported retaining the preferred claim against the presenting bank in the event of a breach of warranty. The group letter stated that because financial institutions treat warranty claims as part of the original check payment that was previously settled to the presenting bank before receivership, the paying bank should have a preference for the warranty claim in receivership above other claims of the failed presenting bank. The other commenter stated that banks do not go through the normal bankruptcy process and that many check warranty claims are processed as “with entry” adjustments through the Federal Reserve or pursuant to the ECCHO rules. The commenter stated that there is an expectation that payments related to the failed bank should be allowed to fully process, including payment of warranty claims on checks cleared prior to such bank’s failure. The Board has retained the preferred claim of the existing regulation and accompanying commentary in current § 229.39(d), redesignated as § 229.39(c).

The Board did not propose changes to existing § 229.39(e), which provides that the suspension of payments by a bank does not prevent any settlement made by that bank from becoming final if finality occurs automatically upon the lapse of time or the occurrence of certain events. The Board has redesignated this provision and its accompanying commentary as § 229.38(d).

11. Section 229.40—Effect of Merger Transaction

Section 229.40 permits merged banks to be considered as separate banks for one year period following consummation of the merger. This section contained a special rule providing an extended period for

⁶² 57 FR 46596 (Oct. 14, 1992). The Board, however, did not intend this to be a “preference” under the Bankruptcy Code (*i.e.*, an avoidable transfer).

mergers that occurred close to the century date change (mergers consummated on or after July 1, 1998, and before March 1, 2000). The Board proposed to remove the special rule as obsolete. The Board also proposed revisions to the examples of regulatory requirements that could be effected by the merger rule. The Board did not receive any comments on the proposal and has removed the special rule and made the commentary revisions with minor technical changes for clarity.

12. Section 229.41—Relation to State Law

Section 229.41 provides that subpart C of Regulation CC supersedes inconsistent provisions of state law, but only to the extent of the inconsistency. The Board did not propose any revisions to the regulation or its accompanying commentary and these provisions are unchanged in the final rule.

13. Section 229.42—Exclusions

Section 229.42 provides that the expeditious return, notice of nonpayment, and same-day settlement requirements of subpart C do not apply to a check drawn on the U.S. Treasury, a U.S. Postal Service money order, or a check drawn on a state or unit of general local government that is not payable through or at a bank. The Board proposed revisions to this section and its accompanying commentary under both Alternatives 1 and 2 to align the provisions with the proposed elimination of the expeditious return requirement (Alternative 1) or the notice of nonpayment requirement (Alternative 2). As the final rule contains both of those requirements, the Board has not adopted any revisions to this section of the regulation and commentary other than corrections to cross-references corresponding to redesignated sections of the final rule-text.

14. Section 229.43—Checks Payable in Guam, American Samoa, and the Northern Mariana Islands

Section 229.43 sets forth the rules applicable to checks that are drawn on banks located in Guam, American Samoa, and the Northern Mariana Islands (Pacific island checks). These checks often bear U.S. routing numbers and are deposited in and collected by U.S. banks, although they do not meet the Regulation CC definition of “check” because they are not drawn on a U.S. bank. Consistent with the expansion of other provisions in the regulation to address electronic checks, the Board proposed expand the definition of “Pacific Island check” to include an

⁶¹ UCC 4–216, cmt. 1.

electronic image of or electronic information related to a demand draft drawn on a Pacific island bank. The Board also proposed two variations of the list of applicable regulatory provisions (and related commentary changes) that apply to Pacific Island checks, one for Alternative 1 and one for Alternative 2. The Board also proposed to revise the commentary to clarify that bank offices in Guam, American Samoa, and the Northern Mariana Islands are banks for purposes of the “Check 21” provisions in subpart D (but not subparts B or C) of the regulation, because the Check 21 Act includes those locations in the definition of “state,” whereas the EFA Act does not.

The Board did not receive any comments on the proposed changes to § 229.43 and its commentary. The Board has adopted a revised list of regulatory provisions applicable to Pacific Island checks to conform to the final rule’s retention of both the expeditious return and the notice of nonpayment requirements. The Board has also revised the definition of “Pacific Island check” to reflect changes to the definition of electronic check discussed above and made corresponding changes to the commentary. The Board has adopted the other regulatory and commentary provisions as proposed.

D. Subpart D—Substitute Checks

1. Section 229.51—General Provisions Governing Substitute Checks

Section 229.51 of Regulation CC sets forth the requirements for a substitute check to be the legal equivalent of the original check. Currently, these provisions require, among other things, that the reconverting bank and truncating bank are identified in accordance with Appendix D of Regulation CC and ANS Specifications for an Image Replacement Document, X9.100–140 (ANS X9.100–140). As discussed above, the Board is removing Appendix D from Regulation CC and instead referring to industry standards, such as ANS X9.100–140. Accordingly, the Board proposed to make conforming changes to § 229.51, removing all references to Appendix D in the regulation and accompanying commentary and making non-substantive organizational revisions to the commentary. The Board did not receive any comments on § 229.51 and has adopted the proposed regulatory and commentary changes with non-substantive editorial corrections.

2. Section 229.52—Substitute Check Warranties

Section 229.52 of Regulation CC sets forth the warranties made by a bank that transfers, presents, or returns a substitute check for which it receives consideration.⁶³ The Board proposed revisions to this section to address the case where a bank rejects a check submitted for deposit (such as through an ATM) and sends back to its customer a substitute check (or a paper or electronic representation of a substitute check). That bank would not receive consideration for that check and therefore would give no warranties under current § 229.52 for the substitute check it created, rendering that substitute check ineligible for legal equivalence under § 229.51(a) (which equivalence requires a bank warranty). The Board proposed a new § 229.52(a)(2) and accompanying commentary to provide that the bank in the situation described above would make the warranties in § 229.52(a) regardless of whether the bank received consideration for the substitute check.

The proposed commentary explained that the bank that creates a substitute check to return to the customer in the scenario addressed by new § 229.52(a)(2) must identify itself on the front of the substitute check as the truncating bank and on the front and back of the check as the reconverting bank (but that the bank is not a depository bank, collecting bank, or returning bank with respect to the check, nor does the bank’s identification of itself on the back of the check as a reconverting bank constitute the bank’s indorsement of the check). The proposed commentary also explained that a bank that is a truncating bank under § 229.2(eee)(2) because it accepts deposit of a check electronically might be subject to a claim by another depository bank that accepts the original check for deposit, pursuant to proposed § 229.34(f).

The Board received one comment on these provisions, which supported the proposal. The Board has adopted the proposed changes to § 229.52 and its accompanying commentary with minor technical clarifications.

3. Section 229.53—Substitute Check Indemnity

Section 229.53 sets forth the indemnity provided by a bank that transfers, presents, or returns a

⁶³ These warranties include a warranty that the substitute check meets the requirements for legal equivalence in § 229.51(a)(1) and (2) and a warranty that no bank will be asked to pay a check that has already been paid (the “no double debit” warranty).

substitute check and receives consideration for the check. For the reasons discussed above in § 229.52, the Board proposed to add a new paragraph to § 229.53(a) and accompanying commentary to provide for an indemnity to be given by a bank that rejects a check submitted for deposit and sends back to its customer a substitute check, but does not receive consideration for the check. The Board did not receive any comments on § 229.53 and has adopted the proposed changes to the regulation and commentary.

4. Section 229.54—Expedited Recredit for Consumers

Section 229.54 addresses a consumer’s ability to make a claim for expedited recredit with respect to a substitute check. The Board proposed to update the cross-references in § 229.54 to reflect the adoption of new warranties for electronic checks, as detailed above § 229.34(a). The Board did not receive any comments on § 229.54 and has adopted the proposed changes to the commentary to update cross-references.

E. Appendix D

For the reasons stated in § 229.35 of this section-by-section analysis the Board has removed and reserved Appendix D.

V. Competitive Impact Analysis

The Board conducts a competitive impact analysis when it considers an operational or legal change, if that change would have a direct and material adverse effect on the ability of other service providers to compete with the Federal Reserve in providing similar services due to legal differences or due to the Federal Reserve’s dominant market position deriving from such legal differences. All operational or legal changes having a substantial effect on payments-system participants will be subject to a competitive-impact analysis, even if competitive effects are not apparent on the face of the proposal. If such legal differences exist, the Board will assess whether the same objectives could be achieved by a modified proposal with lesser competitive impact or, if not, whether the benefits of the proposal (such as contributing to payments-system efficiency or integrity or other Board objectives) outweigh the materially adverse effect on competition.⁶⁴

In general, the Board does not believe that the amendments to Regulation CC have a direct and material adverse effect on the ability of other service providers

⁶⁴ Federal Reserve Regulatory Service, 7–145.2.

to compete effectively with the Reserve Banks in providing similar services due to legal differences (the special case of the same-day settlement rule is discussed below). The amendments, which are intended to foster electronic check collection and return, apply to the Reserve Banks and private-sector service providers alike and do not affect the competitive position of private-sector presenting banks vis-à-vis the Reserve Banks.

Regulation CC's same-day settlement rule, which became effective in 1994, reduced (but did not eliminate) the Reserve Banks' competitive advantage with respect to presentment of paper checks. In 1998, the Board requested comment on whether the same-day settlement rule should be modified to reduce or eliminate the remaining legal disparities between correspondent banks and the Reserve Banks in the presentment and settlement of checks.⁶⁵ Commenters generally concluded that the drawbacks of reducing the remaining legal disparities outweighed any advantage to the Reserve Banks.⁶⁶ Based on an analysis of the comments, the Board did not propose amendments to the same-day settlement rule at that time to reduce or eliminate these remaining legal differences.

Because Regulation CC's same-day settlement rule does not apply to electronic checks, which are governed by agreement, the Board requested comment on whether to adopt an electronic same-day settlement rule in 2011 and again as part of the proposal in 2014. In both instances, commenters voiced significant policy and operational concerns with the application of the same-day settlement rule to electronic checks.

⁶⁵ 63 FR 12700 (March 16, 1998). Under Regulation J, the Reserve Banks have the legal ability to obtain same-day settlement for items they present before the paying bank's cut-off hour (typically 2 p.m. local time), whereas the latest that a private-sector bank may present a paper check for same-day settlement is 8 a.m. local time under Regulation CC's same-day settlement rule. In addition, Reserve Banks receive settlement by debiting the Federal Reserve account of the paying bank or its designated correspondent settlement agent (autocharge), whereas the paying bank settles with a correspondent presenting bank by crediting the Reserve Bank account designated by the presenting bank (such as by Fedwire).

⁶⁶ 63 FR 68701 (Dec. 14, 1998). In particular, commenters expressed concern that extending correspondent banks' presentment deadline to 2 p.m. would disrupt paying banks' corporate cash management services and that moving the Reserve Banks' presentment deadline to earlier in the day would be undesirable because it would slow the collection of checks. In addition, commenters wanted to retain the efficiency of settling for Reserve Bank presentments by autocharge but did not want to extend to correspondent banks the ability to debit the paying bank's account.

A small number of commenters expressed concerns that private-sector presenting banks have not been able to obtain electronic presentment agreements with a broad range of paying banks and stated that an electronic same-day settlement rule would allow private-sector collecting banks to compete more effectively with the Reserve Banks. The Board does not believe, however, that the Reserve Banks' ability to obtain electronic presentment agreements is attributable to legal differences. The Reserve Banks have adopted a business practice to present checks directly whether or not the bank agrees to accept presentment electronically, which provides an incentive for paying banks to accept electronic presentment. A correspondent bank that decides to present checks directly to a paying bank regardless of whether the bank agrees to electronic presentment should likewise be able to obtain such electronic presentment agreements. In many cases, however, correspondent banks have adjusted their back office operations to accommodate only electronic check presentments. The Board believes that these developments reflect business decisions of those correspondent banks rather than unfair competitive advantages of Reserve Banks.⁶⁷

Moreover, in the absence of general industry standards, an electronic same-day settlement rule would need to address the implications of a paying bank communication or technical failure and prescribe technical specifications, such as communication protocols and security requirements. Given the lack of industry support for an electronic same-day settlement rule and the practical challenges of crafting such a rule, the Board has not extended the same-day settlement rule to cover electronic presentment.

The Board has retained the same-day settlement rule for the presentment of paper checks, even though the nation's check collection system is now virtually all-electronic, because of the negotiating

⁶⁷ The Reserve Banks made significant investments in equipment for printing paper substitute checks to facilitate the implementation of the Check 21 Act. They continue to use these capabilities, particularly in the case of check returns, which over 600 endpoints still do not receive electronically. Correspondent banks have generally not made the same investments in printers to create substitute checks as have the Reserve Banks, but could easily do so, individually or collectively, to make paper presentment a realistic option without incurring a significant expense. Although it would not be desirable to increase the proportion of checks presented in paper form, correspondent banks' ability to present paper checks could likely create a sufficient incentive for paying banks to accept checks electronically.

leverage it provides presenting banks in obtaining electronic presentment agreements with paying banks. The Board remains open to considering regulatory changes broadly supported by the industry that reduce legal disparities between the Reserve Banks and private-sector collecting banks and foster the efficiency of the check collection system.

VI. The Riegle Community Development and Regulatory Improvement Act of 1994

The Riegle Community Development Regulatory Improvement Act of 1994 requires that agency regulations that impose additional reporting, disclosure, and other requirements on insured depository institutions take effect on the first calendar quarter following publication in final form. 12 U.S.C. 4802(b). Consistent with the Riegle Community Development Act, this final rule is effective on July 1, 2018.

VII. Paperwork Reduction Act

Certain provisions of the final rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521). In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OMB control number is 7100–0235. In addition, as permitted by the PRA, the Board proposes to extend for three years, with revision, the Disclosure Requirements Associated with Availability of Funds and Collections of Checks (Regulation CC) (Reg CC; OMB No. 7100–0235). The Board reviewed the final rule under the authority delegated to the Board by the OMB.

The final rule contains requirements subject to the PRA. The revised disclosure requirements of this final rule are found in sections 229.31(c) and 229.33(h). Section 229.31(c) imposes a notice of nonpayment requirement on paying banks that determine not to pay a check, both paper and electronic, in the amount of \$5,000 or more. Section 229.33(h) requires a depository bank to notify its customer if the depository bank receives a returned check, notice of nonpayment, or notice of recovery under section 229.35(b). The Board did not receive any specific comments on the PRA analysis.

The Board has a continuing interest in the public's opinions of collections of information. At any time, commenters may submit comments regarding the

burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, to Nuha Elmaghrabi, Federal Reserve Board Clearance Officer, Office of the Chief Data Officer, Board of Governors of the Federal Reserve System, Washington, DC 20551. A copy of the comments may also be submitted to the OMB desk officer (1) by mail to U.S. Office of Management and Budget, 725 17th Street NW., 10235, Washington, DC 20503; (2) by facsimile to 202-395-6974; or (3) by email to: oir_submission@omb.eop.gov, Attention, Federal Banking Agency Desk Officer.

A. Proposed Revision, With Extension, of the Following Information Collection

Title of Information Collection: Disclosure Requirements Associated with Availability of Funds and Collections of Checks (Regulation CC).

Agency form number: Reg CC.

OMB control number: 7100-0235.

Frequency of Response: Event-generated.

Affected Public: Businesses or other for-profit.

Respondents: State member banks and uninsured state branches and agencies of foreign banks.

Estimated annual burden hours: Specific availability policy disclosure and initial disclosures—8,308 hours; Notice in specific policy disclosure—34,895 hours; Notice of exceptions—99,700 hours; Locations where employees accept consumer deposits—249 hours; Annual notice of new ATMs—4,985 hours; Changes in policy—4,000 hours; Providing notice of nonpayment by paying bank—582 hours; Providing notifications to customer—6,148 hours; Expedited recredit for consumers—8,724 hours; Expedited recredit for banks—3,739 hours; Consumer awareness—4,985 hours; and Expedited recredit claim notice—6,231 hours.

Estimated average time per response: Specific availability policy disclosure and initial disclosures—1 minute; Notice in specific policy disclosure—3 minutes; Notice of exceptions—3 minutes; Locations where employees accept consumer deposits—15 minutes; Annual notice of new ATMs—5 hours; Changes in policy—20 hours; Providing notice of nonpayment by paying bank—1 minute; Providing notifications to customer—1 minute; Expedited recredit for consumers—15 minutes; Expedited recredit for banks—15 minutes; Consumer awareness—1 minute; and Expedited recredit claim notice—15 minutes.

Number of respondents: 997 respondents (100 respondents for changes in policy).

Abstract: Regulation CC requires commercial banks, savings associations, credit unions, and U.S. branches and agencies of foreign banks to make funds deposited in transaction accounts available within specified time periods, disclose their availability policies to customers, and begin accruing interest on such deposits promptly. The disclosures are intended to alert customers that their ability to use deposited funds may be delayed, prevent unintentional (and potentially costly) overdrafts, and allow customers to compare the policies of different banks before deciding at which bank to deposit funds. The regulation also requires notice to the depository bank and to a customer of nonpayment of a check. Model disclosure forms, clauses, and notices are appended to the regulation to ease compliance.

Current Action: Regulation CC currently requires a paying bank that determines not to pay a check in the amount of \$2,500 or more. Return of the check itself satisfies the notice of nonpayment requirement if the return meets the timeframe requirement for the notice. Under the Board's final rule, a paying bank is required to provide a notice of nonpayment if a paying bank determines not to pay a check in the amount of \$5,000 or more. (Return of the check itself would continue to satisfy the notice requirement if the return meets the timeframe requirement for notice.) The Board therefore expects that its final rule will reduce the number of notices that paying banks send.

Regulation CC also currently requires a depository bank to notify its customer when it receives a returned check or notice of nonpayment related to that customer's account. The final rule requires that the depository bank notify its customer when the bank receives a notice of recovery under 229.35(b). The Board does not expect that this new requirement will significantly affect the burden of depository banks.

VIII. Regulatory Flexibility Act

An initial regulatory flexibility analysis (IRFA) was included in the proposal in accordance with section 3(a) of the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA). In the IRFA, the Board requested comment on all aspects of the IRFA, and, in particular, comments on the cost of the proposed expeditious return rules to small depository institutions. The Board also requested comments on any approaches, other than the proposed alternatives,

that would reduce the burden on all entities. Finally, the Board requested comments on any significant alternatives that would minimize the impact of the proposal on small entities.

The RFA requires an agency to prepare a final regulatory flexibility analysis (FRFA) unless the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. In accordance with section 3(a) of the RFA, the Board has reviewed the final regulation. The final rule applies to all depository institutions. The Board has prepared the following FRFA pursuant to the RFA.

B. Statement of the Need for, and Objectives of, the Final Rule

The Board is finalizing the foregoing amendments to Regulation CC pursuant to its authority under the EFA Act and the Check 21 Act. The final rule reflects the substantial transition in the collection of checks from a largely paper-based process to one that is virtually all-electronic. The full benefits and cost savings of the electronic check-processing methods facilitated by the Check 21 Act cannot be realized so long as some banks continue to employ paper-processing methods. The objective of the final rule is to encourage all banks to collect and return checks electronically.

C. Description of Small Entities Affected by the Final Rule

The final rule would apply to all depository institutions regardless of their size.⁶⁸ Pursuant to regulations issued by the Small Business Administration (13 CFR 121.201), a "small banking organization" includes a depository institution with \$550 million or less in total assets. Based on call report data as of December 2016, there are approximately 10,185 depository institutions that have total domestic assets of \$550 million or less and thus are considered small entities for purposes of the RFA. Based on data regarding checks returned through the Reserve Banks, the Board estimates that by the beginning of 2017, approximately 89 percent of small depository institutions have arrangements to receive returned checks electronically, whereas 11 percent (approximately 500 small depository institutions) had not.

⁶⁸The final rule would not impose costs on any small entities other than depository institutions.

D. Summary of Significant Issues Raised by Public Comments in Response to the Board's IRFA, the Board's Assessment of Such Issues, and a Statement of Any Changes Made as a Result of Such Comments

The Board did not receive any comments explicitly in response to the IRFA in the proposed rule. Commenters, however, discussed the proposed rule's impact on small entities. Some commenters expressed concerns that the proposed expeditious return requirements, both Alternatives 1 and 2, would penalize small entities that still require paper returns. Some commenters also stated that the Board's proposed remote deposit capture indemnity would be too burdensome on small institutions and discourage them from offering the service to its customers.

In the final rule, as described in detail above, the Board adopted an expeditious return requirement that incorporates elements of both alternatives that had been proposed. The final rule's expeditious return requirement is intended to encourage the broadest possible implementation of electronic check return for those remaining institutions still using paper. A small depository bank that currently receives returned checks in paper form and that chooses to begin to receive returned checks electronically will incur some cost associated with that transition. As explained in more detail below, the Board continues to expect that these costs would be relatively low for a small depository bank, which typically would receive only a small volume of returned checks. Under the final rule, small depository banks may also choose to accept only paper returns; however, they will not be able to make a claim against the paying bank or returning bank that a check was not returned expeditiously. The Board expects that each small depository bank will weigh the costs and benefits of whether to accept returns electronically.

In the final rule, the Board adopted the proposed remote deposit capture indemnity, with an added exception. Some of the commenters that stated the proposed remote capture indemnity would cause small entities to stop offering remote capture indemnity suggested that the Board incorporate a provision such that a depository bank that accepts an original check containing a restrictive indorsement inconsistent with the means of deposit should not be able to make an indemnity claim. The Board has added this exception to the indemnity and associated commentary, as described in

detail above. A depository institution, whether small or large, that accepts a check via remote deposit capture can protect itself through rules and safeguards with respect to the actions of its own customer and is in the best position to guard against the subsequent deposit of the paper check.

E. Projected Reporting, Recordkeeping, and Other Compliance Requirements

By conditioning the depository bank's ability to make an expeditious return claim on whether it has commercially reasonable arrangements in place to receive the returned check electronically, the final rule would encourage, but not require, depository banks to accept check returns in electronic form. As stated above, a depository bank that currently receives returned checks in paper form and that chooses to begin to receive returned checks electronically will incur some cost associated with that transition. The Board continues to expect that these costs would be relatively low for a small depository bank, which typically would receive only a small volume of returned checks. For example, the Federal Reserve Banks offer a product under which they deliver electronically to small depository banks copies (.pdf files) of returned checks, which the banks can print on their own premises if necessary.⁶⁹ To receive returned checks in this fashion, a depository bank may need to establish an electronic connection to a Reserve Bank, or another returning bank that offers a similar service, and to purchase certain equipment, such as a printer capable of double-sided printing and magnetic-ink toner cartridges. Depending on the volume of returned checks that a small depository bank receives, the Board continues to estimate that this transition would cost a small depository bank approximately \$3,000 annually.⁷⁰

Conversely, a small depository bank that does not choose to accept returned checks electronically would, under the final rule, incur additional risk associated with that decision. Specifically, if a paper returned check is not delivered to the bank in a timely

fashion, the bank might make funds available to its depositor before learning whether the check has been returned unpaid. A depository bank that has no arrangements in place to accept returned checks electronically will be unable to make an expeditious return claim against the paying bank or returning bank. As stated above, it is reasonable to expect that each small depository bank will weigh the costs and benefits of whether to accept returns electronically. If the bank determines that the net present value of the risk is greater than the cost to receive returned checks electronically, then the bank can minimize its cost associated with the Board's rule by making arrangements to accept returned checks electronically, directly or indirectly, by commercially reasonable means from the paying bank or returning bank.

Any costs to a small depository bank that may result from the rule will be offset to some extent by savings to the bank in other areas. For example, receiving returned checks electronically may enable a small bank to reduce its ongoing operating costs associated with receiving and processing returned checks.

Regulation CC currently requires a paying bank that determines not to pay a check in the amount of \$2,500 or more to provide notice of nonpayment such that the notice is received by the depository bank by 4 p.m. (local time) on the second business day following the banking day on which the check was presented to the paying bank. Return of the check itself satisfies the notice of nonpayment requirement if the return meets the timeframe requirement for the notice. Under the Board's final rule, a paying bank is required to provide a notice of nonpayment if a paying bank determines not to pay a check in the amount of \$5,000 or more. (Return of the check itself would continue to satisfy the notice requirement if the return meets the timeframe requirement for notice.) The Board therefore expects that its final rule will reduce the number of notices that paying banks send.

The final rule also requires that the paying bank send a notice of nonpayment such that the notice or check would normally be received by the depository bank by 2 p.m. local time of the depository bank, as opposed to the currently required 4 p.m. local time, on the second business day following the banking day of presentment. This earlier required time for receipt by the depository bank may impose additional cost on the paying bank sending notice or returned check. However, any

⁶⁹ After printing the .pdf files, the depository bank would be able to process the checks exactly as it would process paper checks physically delivered to it.

⁷⁰ This estimate takes into account the cost to a small depository bank to establish and maintain an electronic connection to a Reserve Bank, which is estimated to be \$190 per month. See 81 FR 75058 (Oct. 28, 2016). Some small banks already have such a connection. Further, a small depository bank may choose to receive its returns electronically in a manner that does not require this connection, such as through a banker's bank, corporate credit union, or nonbank processor.

increased cost to a paying bank associated with delivering a notice or returned check by the earlier time may not be material depending on a bank's current processing schedules, and it may be offset by reduced depository bank losses associated with checks that are returned unpaid. Furthermore, the Board does not expect the earlier required time to incur any additional cost for paying banks that rely on the return of the check to satisfy its notice of nonpayment requirement because both must be sent such that the notice or check would normally be received by the depository bank by 2 p.m. on the second business day following the banking day of presentment.

Regulation CC currently applies only to paper checks. In the final rule, the Board is amending Regulation CC to create a regulatory framework for the collection and return of electronic images and electronic information. This framework includes applying existing paper-check warranties and the Check-21-like warranties to electronic checks and electronic returned checks. These warranties include, for example, the returned-check warranties; the notice of nonpayment warranties; the settlement amount, encoding, and offset warranties; and the transfer and presentment warranties related to a remotely created check. These warranties can be varied by agreement between banks. The Board does not expect depository institutions to incur extra costs associated with these changes, as in many cases these or similar warranties are generally included in interbank agreements for electronic image exchange or in clearinghouse rules. In addition, while the new warranties impose liabilities on the warranting entities, the Board believes that the current practices of most institutions in the check collection chain are consistent with the warranties and does not expect that warranting entities will need to take any additional steps to protect themselves.

The Board has adopted in the final rule indemnities for electronically-created items and remote deposit capture, as described fully above. The Board believes that these indemnities place appropriate incentives on the parties best positioned to minimize risk. The Board finds that it is reasonable to expect that small depository banks will weigh the costs and benefits associated with transferring electronically-created items, as well as offering remote deposit capture, and take the appropriate precautions to limit risk.

For example, a depository bank that is unsure whether an electronically-created item was authorized may choose

not to accept the item for deposit. A bank that does accept such an item and sends it for collection accepts the risk that it may be required to indemnify a subsequent bank collecting bank from any losses due to the fact that the item was not authorized. Similarly, a bank that offers remote deposit capture may require that the customer endorse the check with the words "for mobile deposit only" before capturing the check or take other steps to protect against a deposit of the original check. The Board believes that these indemnities will provide basic protections for banks handling electronically-created items and help prevent multiple deposits of the same item.

F. Significant Alternatives to the Proposed Rule

As discussed above in this **Federal Register** notice and in the 2011 and 2014 proposals, the Board has extensively considered possible alternatives to the expeditious return requirement and framework for electronic checks. As explained in detail in the preamble, the Board believes that the other alternatives would either impose greater costs on small entities than would this final rule, or would be less effective in providing appropriate incentives for electronic check collection.

List of Subjects in 12 CFR Part 229

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

Authority and Issuance

For the reasons set forth in the preamble, the Board amends 12 CFR part 229 as follows:

PART 229—AVAILABILITY OF FUNDS AND COLLECTION OF CHECKS (REGULATION CC)

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

Authority: 12 U.S.C. 4001–4010, 12 U.S.C. 5001–5018.

Subpart A—General

- 2. In § 229.1, paragraph (b)(3) is revised and paragraphs (b)(5) through (10) are added to read as follows:

§ 229.1 Authority and purpose; organization

* * * * *

(b) * * *

(3) Subpart C of this part contains rules to expedite the collection and return of checks and electronic checks by banks. These rules cover the direct

return of checks and electronic checks, the manner in which the paying bank and returning banks must return checks and electronic checks to the depository bank, notification of nonpayment by the paying bank, indorsement and presentment of checks and electronic checks, same-day settlement for certain checks, the liability of banks for failure to comply with subpart C of this part, and other matters.

* * * * *

(5) Appendix A of this part contains a routing number guide to next day-availability checks. The guide lists the routing numbers of checks drawn on Federal Reserve Banks and Federal Home Loan Banks, and U.S. Treasury checks and Postal money orders that are subject to next-day availability.

(6) Appendix B of this part is reserved.

(7) Appendix C of this part contains model funds-availability policy disclosures, clauses, and notices and a model disclosure and notices related to substitute-check policies.

(8) Appendix D of this part is reserved.

(9) Appendix E of this part contains Board interpretations, which are labeled "Commentary," of the provisions of this part. The Commentary provides background material to explain the Board's intent in adopting a particular part of the regulation and provides examples to aid in understanding how a particular requirement is to work. The Commentary is an official Board interpretation under section 611(e) of the EFA Act (12 U.S.C. 4010(e)).

(10) Appendix F of this part contains the Board's determinations of the EFA Act and Regulation CC's preemption of state laws that were in effect on September 1, 1989.

■ 3. In § 229.2, paragraphs (dd), (uu), (vv), and (bbb) are revised and paragraphs (ggg) and (hhh) are added to read as follows:

§ 229.2 Definitions

* * * * *

(dd) *Routing number* means—

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

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

(3) For purposes of subpart C and subpart D, the bank-identification number contained in an electronic check or electronic returned check.

* * * * *

(uu) *Indemnifying bank*. Indemnifying bank means—

(1) For the purposes of § 229.34, a bank that provides an indemnity under

§ 229.34 with respect to remote deposit capture or an electronically-created item, or

(2) For the purposes of § 229.53, a bank that provides an indemnity under § 229.53 with respect to a substitute check.

(vv) *Magnetic ink character recognition line* and *MICR line* mean the numbers, which may include the routing number, account number, check number, check amount, and other information, that are (unless the Board by rule or order determines that different standards apply)—

(1) Printed near the bottom of a check in magnetic ink in accordance with American National Standard Specifications for Placement and Location of MICR Printing, X9.13 (hereinafter ANS X9.13) for an original check and American National Standard Specifications for an Image Replacement Document—IRD, X9.100–140 (hereinafter ANS X9.100–140) for a substitute check, or

(2) For purposes of subpart C and subpart D, contained in a record specified for MICR line data in an electronic check or electronic returned check in accordance with American National Standard Specifications for Electronic Exchange of Check Image Data—Domestic, X9.100–187 (hereinafter ANS X9.100–187).

* * * * *

(bbb) *Copy and sufficient copy.* (1) A copy of an original check means—

(i) Any paper reproduction of an original check, including a paper printout of an electronic image of the check, a photocopy of the original check, or a substitute check; or

(ii) Any electronic reproduction of a check that a recipient has agreed to receive from the sender instead of a paper reproduction.

(2) A *sufficient copy* is a copy of an original check that accurately represents all of the information on the front and back of the original check as of the time the original check was truncated or is otherwise sufficient to determine whether or not a claim is valid.

* * * * *

(ggg) *Electronic check* and *electronic returned check* mean an electronic image of, and electronic information derived from, a paper check or paper returned check, respectively, that—

(1) Is sent to a receiving bank pursuant to an agreement between the sender and the receiving bank; and

(2) Conforms with ANS X9.100–187, unless the Board by rule or order determines that a different standard applies or the parties otherwise agree.

(hhh) *Electronically-created item* means an electronic image that has all

the attributes of an electronic check or electronic returned check but was created electronically and not derived from a paper check.

Subpart C—Collection of Checks

■ 4. Section 229.30 is revised to read as follows:

§ 229.30 Electronic checks and electronic information.

(a) *Checks under this subpart.* Electronic checks and electronic returned checks are subject to this subpart as if they were checks or returned checks, except where “paper check” or “paper returned check” is specified. For the purposes of this subpart, the term “check” or “returned check” as used in Subpart A includes “electronic check” or “electronic returned check,” except where “paper check” or “paper returned check” is specified.

(b) *Writings.* If a bank is required to provide information in writing under this subpart, the bank may satisfy that requirement by providing the information electronically if the receiving bank agrees to receive that information electronically.

■ 5. Section 229.31 is revised to read as follows:

§ 229.31 Paying bank’s responsibility for return of checks and notices of nonpayment.

(a) *Return of checks.* (1) Subject to the requirement of expeditious return under paragraph (b) of this section, a paying bank may send a returned check to the depository bank, to any other bank agreeing to handle the returned check, or as provided in paragraph (a)(2) of this section.

(2) A paying bank that is unable to identify the depository bank with respect to a check may send the returned check to any bank that handled the check for forward collection and must advise the bank to which the check is sent that the paying bank is unable to identify the depository bank.

(3) A paying bank may convert a check to a qualified returned check. A qualified returned check shall be encoded in magnetic ink with the routing number of the depository bank, the amount of the returned check, and a “2” in the case of an original check (or a “5” in the case of a substitute check) in position 44 of the qualified return MICR line as a return identifier. A qualified returned original check shall be encoded in accordance with ANS X9.13, and a qualified returned substitute check shall be encoded in accordance with ANS X9.100–140.

(4) Except as provided in paragraph (g) of this section, this section does not affect a paying bank’s responsibility to return a check within the deadlines required by the UCC or Regulation J (12 CFR part 210).

(b) *Expeditious return of checks.* (1) Except as provided in paragraph (d) of this section, if a paying bank determines not to pay a check, it shall return the check in an expeditious manner such that the check would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank.

(2) If the second business day following the banking day on which the check was presented to the paying bank is not a banking day for the depository bank, the paying bank satisfies the expeditious return requirement if it sends the returned check in a manner such that the depository bank would normally receive the returned check not later than 2 p.m. (local time of the depository bank) on the depository bank’s next banking day.

(c) *Notice of nonpayment.* (1) If a paying bank determines not to pay a check in the amount of \$5,000 or more, it shall provide notice of nonpayment such that the notice would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank. If the day the paying bank is required to provide notice is not a banking day for the depository bank, receipt of notice not later than 2 p.m. (local time of the depository bank) on the depository bank’s next banking day constitutes timely notice. Notice may be provided by any reasonable means, including the returned check, a writing (including a copy of the check), or telephone.

(2)(i) To the extent available to the paying bank, notice must include the information contained in the check’s MICR line when the check is received by the paying bank, as well as—

- (A) Name of the payee(s);
- (B) Amount;
- (C) Date of the indorsement of the depository bank;
- (D) The bank name, routing number, and trace or sequence number associated with the indorsement of the depository bank; and
- (E) Reason for nonpayment.

(ii) If the paying bank is not sure of the accuracy of an item of information, it shall include the information required by this paragraph to the extent possible,

and identify any item of information for which the bank is not sure of the accuracy.

(iii) The notice may include other information from the check that may be useful in identifying the check being returned and the customer.

(d) *Exceptions to the expeditious return of checks and notice of nonpayment requirements.* The expeditious return and notice of nonpayment requirements of paragraphs (b) and (c) of this section do not apply if—

(1) The check is deposited in a depository bank that is not subject to subpart B of this part; or

(2) A paying bank is unable to identify the depository bank with respect to the check.

(e) *Identification of returned check.* A paying bank returning a check shall clearly indicate on the front of the check that it is a returned check and the reason for return. If the paying bank is returning a substitute check or an electronic returned check, the paying bank shall include this information such that the information would be retained on any subsequent substitute check.

(f) *Notice in Lieu of Return.* If a check is unavailable for return, the paying bank may send in its place a copy of the front and back of the returned check, or, if no such copy is available, a written notice of nonpayment containing the information specified in paragraph (c)(2) of this section. The copy or written notice shall clearly state that it constitutes a notice in lieu of return. A notice in lieu of return is considered a returned check subject to the requirements of this subpart.

(g) *Extension of deadline.* The deadline for return or notice of dishonor or nonpayment under the UCC or Regulation J (12 CFR part 210), or § 229.36(d)(3) and (4) is extended to the time of dispatch of such return or notice if the depository bank (or the receiving bank, if the depository bank is unidentifiable) receives the returned check or notice—

(1) On or before the depository bank's (or receiving bank's) next banking day following the otherwise applicable deadline by the earlier of the close of that banking day or a cutoff hour of 2 p.m. (local time of the depository bank or receiving bank) or later set by the depository bank (or receiving bank) under UCC 4–108, for all deadlines other than those described in paragraph (g)(2) of this section; or

(2) Prior to the cut-off hour for the next processing cycle (if sent to a returning bank), or on the next banking day (if sent to the depository bank), for a deadline falling on a Saturday that is

a banking day (as defined in the UCC) for the paying bank.

(h) *Payable-through and payable-at checks.* A check payable at or through a paying bank is considered to be drawn on that bank for purposes of the expeditious return and notice of nonpayment requirements of this subpart.

(i) *Reliance on routing number.* A paying bank may return a returned check based on any routing number designating the depository bank appearing on the returned check in the depository bank's indorsement.

■ 6. Section 229.32 is revised to read as follows:

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

(a) *Return of checks.* (1) Subject to the requirement of expeditious return under paragraph (b) of this section, a returning bank may send a returned check to the depository bank, to any other bank agreeing to handle the returned check, or as provided in paragraph (a)(2) of this section.

(2) A returning bank that is unable to identify the depository bank with respect to a check may send the returned check to any collecting bank that handled the returned check for forward collection if the returning bank was not a collecting bank with respect to the returned check, or to a prior collecting bank, if the returning bank was a collecting bank with respect to the returned check. A returning bank sending a returned check under this paragraph to a bank must advise the bank to which the returned check is sent that the returning bank is unable to identify the depository bank.

(3) A returning bank may convert a check to a qualified returned check. A qualified returned check shall be encoded in magnetic ink with the routing number of the depository bank, the amount of the returned check, and a "2" in the case of an original check (or a "5" in the case of a substitute check) in position 44 of the qualified return MICR line as a return identifier. A qualified returned original check shall be encoded in accordance with ANS X9.13, and a qualified returned substitute check shall be encoded in accordance with ANS X9.100–140.

(b) *Expeditious return of checks.* (1) Except as provided in paragraph (c) of this section, a returning bank shall return a returned check in an expeditious manner such that the check would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the

banking day on which the check was presented to the paying bank.

(2) If the second business day following the banking day on which the check was presented to the paying bank is not a banking day for the depository bank, the returning bank satisfies the expeditious return requirement if it sends the returned check in a manner such that the depository bank would normally receive the returned check not later than 2 p.m. (local time of the depository bank) on the depository bank's next banking day.

(c) *Exceptions to the expeditious return of checks.* The expeditious return requirement of paragraph (b) of this section does not apply if—

(1) The check is deposited in a depository bank that is not subject to subpart B of this part;

(2) A paying bank is unable to identify the depository bank with respect to the check; or

(3) The bank handles a misrouted returned check pursuant to § 229.33(f).

(d) *Notice in Lieu of Return.* If a check is unavailable for return, the returning bank may send in its place a copy of the front and back of the returned check, or, if no such copy is available, a written notice of nonpayment containing the information specified in § 229.31(c). The copy or written notice shall clearly state that it constitutes a notice in lieu of return. A notice in lieu of return is considered a returned check subject to the requirements of this section and the other requirements of this subpart.

(e) *Settlement.* A returning bank shall settle with a bank sending a returned check to it for return by the same means that it settles or would settle with the sending bank for a check received for forward collection drawn on the depository bank. This settlement is final when made.

(f) *Charges.* A returning bank may impose a charge on a bank sending a returned check for handling the returned check.

(g) *Reliance on routing number.* A returning bank may return a returned check based on any routing number designating the depository bank appearing on the returned check in the depository bank's indorsement or in magnetic ink on a qualified returned check.

■ 7. Section 229.33 is revised to read as follows:

§ 229.33 Depository bank's responsibility for returned checks and notices of nonpayment.

(a) *Right to assert claim.* (1) A paying bank or returning bank may be liable to a depository bank under § 229.38 for failing to return a check in an

expeditious manner only if the depository bank has arrangements in place such that the paying bank or returning bank could return a returned check to the depository bank electronically, directly or indirectly, by commercially reasonable means.

(2) For purposes of paragraph (a)(1) of this section, the depository bank that has asserted a claim has the burden of proof for demonstrating that the depository bank's arrangements meet the standard of paragraph (a)(1).

(b) *Acceptance of electronic returned checks and electronic notices of nonpayment.* A depository bank's agreement with the transferor bank governs the terms under which the depository bank will accept electronic returned checks and electronic written notices of nonpayment.

(c) *Acceptance of paper returned checks and paper notices of nonpayment.* (1) A depository bank shall accept paper returned checks and paper notices of nonpayment during its banking day—

(i) At a location, if any, at which presentment of paper checks for forward collection is requested by the depository bank; and

(ii)(A) At a branch, head office, or other location consistent with the name and address of the bank in its indorsement on the check;

(B) If no address appears in the indorsement, at a branch or head office associated with the routing number of the bank in its indorsement on the check; or

(C) If no routing number or address appears in its indorsement on the check, at any branch or head office of the bank.

(2) A depository bank may require that paper returned checks be separated from paper forward collection checks.

(d) *Acceptance of oral notices of nonpayment.* A depository bank shall accept oral notices of nonpayment during its banking day—

(1) At the telephone number indicated in the indorsement; and

(2) At any other number held out by the bank for receipt of notice of nonpayment.

(e) *Payment.* (1) A depository bank shall pay the returning bank or paying bank returning the check to it for the amount of the check prior to the close of business on the depository bank's banking day on which it received the check ("payment date") by—

(i) Debit to an account of the depository bank on the books of the returning bank or paying bank;

(ii) Cash;

(iii) Wire transfer; or

(iv) Any other form of payment acceptable to the returning bank or paying bank.

(2) The proceeds of the payment must be available to the returning bank or paying bank in cash or by credit to an account of the returning bank or paying bank on or as of the payment date. If the payment date is not a banking day for the returning bank or paying bank or the depository bank is unable to make the payment on the payment date, payment shall be made by the next day that is a banking day for the returning bank or paying bank. These payments are final when made.

(f) *Misrouted returned checks and written notices of nonpayment.* If a bank receives a returned check or written notice of nonpayment on the basis that it is the depository bank, and the bank determines that it is not the depository bank with respect to the check or notice, it shall either promptly send the returned check or notice to the depository bank directly or by means of a returning bank agreeing to handle the returned check or notice, or send the check or notice back to the bank from which it was received.

(g) *Charges.* A depository bank may not impose a charge for accepting and paying checks being returned to it.

(h) *Notification to customer.* If the depository bank receives a returned check, notice of nonpayment, or notice of recovery under § 229.35(b), it shall send or give notice to its customer of the facts by midnight of the banking day following the banking day on which it received the returned check, notice of nonpayment, or notice of recovery, or within a longer reasonable time.

(i) *Depository bank without accounts.* The requirements of this section with respect to notices of nonpayment do not apply to checks deposited in a depository bank that does not maintain accounts.

■ 8. Section 229.34 is revised to read as follows:

§ 229.34 Warranties and indemnities.

(a) *Warranties with respect to electronic checks and electronic returned checks.* (1) Each bank that transfers or presents an electronic check or electronic returned check and receives a settlement or other consideration for it warrants that—

(i) The electronic image accurately represents all of the information on the front and back of the original check as of the time that the original check was truncated and the electronic information includes an accurate record of all MICR line information required for a substitute check under § 229.2(aaa) and the amount of the check, and

(ii) No person will receive a transfer, presentment, or return of, or otherwise be charged for an electronic check or

electronic returned check, the original check, a substitute check, or a paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid.

(2) Each bank that makes the warranties under paragraph (a)(1) of this section makes the warranties to—

(i) In the case of transfers for collection or presentment, the transferee bank, any subsequent collecting bank, the paying bank, and the drawer; and

(ii) In the case of transfers for return, the transferee returning bank, any subsequent returning bank, the depository bank, and the owner.

(b) *Transfer and presentment warranties with respect to a remotely created check.* (1) A bank that transfers or presents a remotely created check and receives a settlement or other consideration warrants to the transferee bank, any subsequent collecting bank, and the paying bank that the person on whose account the remotely created check is drawn authorized the issuance of the check in the amount stated on the check and to the payee stated on the check. For purposes of this paragraph (b)(1), "account" includes an account as defined in § 229.2(a) as well as a credit or other arrangement that allows a person to draw checks that are payable by, through, or at a bank.

(2) If a paying bank asserts a claim for breach of warranty under paragraph (b)(1) of this section, the warranting bank may defend by proving that the customer of the paying bank is precluded under UCC 4-406, as applicable, from asserting against the paying bank the unauthorized issuance of the check.

(c) *Settlement amount, encoding, and offset warranties.* (1) Each bank that presents one or more checks to a paying bank and in return receives a settlement or other consideration warrants to the paying bank that the total amount of the checks presented is equal to the total amount of the settlement demanded by the presenting bank from the paying bank.

(2) Each bank that transfers one or more checks or returned checks to a collecting bank, returning bank, or depository bank and in return receives a settlement or other consideration warrants to the transferee bank that the accompanying information, if any, accurately indicates the total amount of the checks or returned checks transferred.

(3) Each bank that presents or transfers a check or returned check warrants to any bank that subsequently handles it that, at the time of presentment or transfer, the information

encoded after issue regarding the check or returned check is accurate. For purposes of this paragraph, the information encoded after issue regarding the check or returned check means any information that could be encoded in the MICR line of a paper check.

(4) If a bank settles with another bank for checks presented, or for returned checks for which it is the depository bank, in an amount exceeding the total amount of the checks, the settling bank may set off the excess settlement amount against subsequent settlements for checks presented, or for returned checks for which it is the depository bank, that it receives from the other bank.

(d) *Returned check warranties.* (1) Each paying bank or returning bank that transfers a returned check and receives a settlement or other consideration for it warrants to the transferee returning bank, to any subsequent returning bank, to the depository bank, and to the owner of the check, that—

(i) The paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, returned the check within its deadline under the UCC or § 229.31(g) of this part;

(ii) It is authorized to return the check;

(iii) The check has not been materially altered; and

(iv) In the case of a notice in lieu of return, the check has not and will not be returned.

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

(e) *Notice of nonpayment warranties.* (1) Each paying bank that gives a notice of nonpayment warrants to the transferee bank, to any subsequent transferee bank, to the depository bank, and to the owner of the check that—

(i) The paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, returned or will return the check within its deadline under the UCC or § 229.31(g) of this part;

(ii) It is authorized to send the notice; and

(iii) The check has not been materially altered.

(2) These warranties are not made with respect to checks drawn on the Treasury of the United States, U.S. Postal Service money orders, or check drawn on a state or a unit of general

local government that are not payable through or at a bank.

(f) *Remote deposit capture indemnity.*

(1) The indemnity described in paragraph (f)(2) of this section is provided by a depository bank that—

(i) Is a truncating bank under § 229.2(eee)(2) because it accepts deposit of an electronic image or other electronic information related to an original check;

(ii) Does not receive the original check;

(iii) Receives settlement or other consideration for an electronic check or substitute check related to the original check; and

(iv) Does not receive a return of the check unpaid.

(2) A bank described in paragraph (f)(1) of this section shall indemnify, as set forth in § 229.34(i), a depository bank that accepts the original check for deposit for losses incurred by that depository bank if the loss is due to the check having already been paid.

(3) A depository bank may not make an indemnity claim under paragraph (f)(2) of this section if the original check it accepted for deposit bore a restrictive indorsement inconsistent with the means of deposit.

(g) *Indemnities with respect to electronically-created items.* Each bank that transfers or presents an electronically-created item and receives a settlement or other consideration for it shall indemnify, as set forth in § 229.34(i), each transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against losses that result from the fact that—

(1) The electronic image or electronic information is not derived from a paper check;

(2) The person on whose account the electronically-created item is drawn did not authorize the issuance of the item in the amount stated on the item or to the payee stated on the item (for purposes of this paragraph (g)(2), “account” includes an account as defined in section 229.2(a) as well as a credit or other arrangement that allows a person to draw checks that are payable by, through, or at a bank); or

(3) A person receives a transfer, presentment, or return of, or otherwise is charged for an electronically-created item such that the person is asked to make payment based on an item or check it has already paid.

(h) *Damages.* Damages for breach of the warranties in this section shall not exceed the consideration received by the bank that presents or transfers a check or returned check, plus interest

compensation and expenses related to the check or returned check, if any.

(i) *Indemnity amounts.* (1) The amount of the indemnity in paragraphs (f)(2) and (g) of this section shall not exceed the sum of—

(i) The amount of the loss of the indemnified bank, up to the amount of the settlement or other consideration received by the indemnifying bank; and

(ii) Interest and expenses of the indemnified bank (including costs and reasonable attorney’s fees and other expenses of representation).

(2)(i) If a loss described in paragraph (f)(2) or (g) of this section results in whole or in part from the indemnified bank’s negligence or failure to act in good faith, then the indemnity amount described in paragraph (i)(1) of this section shall be reduced in proportion to the amount of negligence or bad faith attributable to the indemnified bank.

(ii) Nothing in this paragraph (i)(2) affects the rights of a person under the UCC or other applicable provision of state or federal law.

(j) *Tender of defense.* If a bank is sued for breach of a warranty or for indemnity under this section, it may give a prior bank in the collection or return chain written notice of the litigation, and the bank notified may then give similar notice to any other prior bank. If the notice states that the bank notified may come in and defend and that failure to do so will bind the bank notified in an action later brought by the bank giving the notice as to any determination of fact common to the two litigations, the bank notified is so bound unless after reasonable receipt of the notice the bank notified does come in and defend.

(k) *Notice of claim.* Unless a claimant gives notice of a claim for breach of warranty or for indemnity under this section to the bank that made the warranty or indemnification within 30 days after the claimant has reason to know of the breach or facts and circumstances giving rise to the indemnity and the identity of the warranting or indemnifying bank, the warranting or indemnifying bank is discharged to the extent of any loss caused by the delay in giving notice of the claim.

■ 9. In § 229.35, paragraphs (a) and (d) are revised to read as follows:

§ 229.35 Indorsements.

(a) *Indorsement standards.* A bank (other than a paying bank) that handles a check during forward collection or a returned check shall indorse the check in a manner that permits a person to interpret the indorsement, in accordance with American National

Standard (ANS) Specifications for Physical Check Endorsements, X9.100–111 (ANS X9.100–111), for a paper check other than a substitute check; ANS Specifications for an Image Replacement Document, X9.100–140 (ANS X9.100–140), for a substitute check; and ANS Specifications for Electronic Exchange of Check and Image Data—Domestic, X9.100–187 (ANS X9.100–187), for an electronic check; unless the Board by rule or order determines that different standards apply or the parties otherwise agree.

* * * * *

(d) *Indorsement for depositary bank.* A depositary bank may arrange with another bank to apply the other bank's indorsement as the depositary bank indorsement, provided that any indorsement of the depositary bank on the check avoids the area reserved for the depositary bank indorsement as specified in the indorsement standard applicable to the check under paragraph (a) of this section. The other bank indorsing as depositary bank is considered the depositary bank for purposes of subpart C of this part.

■ 10. Section 229.36 is revised to read as follows:

§ 229.36 Presentment and issuance of checks.

(a) *Receipt of electronic checks.* The terms under which a paying bank will accept presentment of an electronic check is governed by the paying bank's agreement with the presenting bank.

(b) *Receipt of paper checks.* (1) A paper check is considered received by the paying bank when it is received—

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

(ii) At an address of the bank associated with the routing number on the check, whether contained in the MICR line or in fractional form;

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

(iv) At any branch or head office, if the bank is identified on the check by name without address.

(2) A bank may require that checks presented to it as a paying bank be separated from returned checks.

(c) *Liability of bank during forward collection.* Settlements between banks for the forward collection of a check are final when made; however, a collecting bank handling a check for forward collection may be liable to a prior collecting bank, including the depositary bank, and the depositary bank's customer.

(d) *Same-day settlement.* (1) A paper check is considered presented, and a paying bank must settle for or return the check pursuant to paragraph (d)(2) of this section, if a presenting bank delivers the check in accordance with reasonable delivery requirements established by the paying bank and demands payment under this paragraph (d)—

(i) At a location designated by the paying bank for receipt of paper checks under this paragraph (d) at which the paying bank would be considered to have received the paper check under paragraph (b) of this section or, if no location is designated, at any location described in paragraph (b) of this section; and

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

(2) A paying bank may require that paper checks presented for settlement pursuant to paragraph (d)(1) of this section be separated from other forward-collection checks or returned checks.

(3) If presentment of a paper check meets the requirements of paragraph (d)(1) of this section, the paying bank is accountable to the presenting bank for the amount of the check unless, by the close of Fedwire on the business day 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 presenting bank; or

(ii) Returns the check.

(4) Notwithstanding paragraph (d)(3) of this section, if a paying bank closes on a business day and receives presentment of a paper check on that day in accordance with paragraph (d)(1) of this section—

(i) The paying bank is accountable to the presenting bank for the amount of the check unless, by the close of Fedwire on its next banking day, it either—

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

(B) Returns the check.

(ii) If the closing is voluntary, unless the paying bank settles for or returns the check in accordance with paragraph (d)(3) of this section, it shall pay interest compensation to the presenting bank for each day after the business day on which the check was presented until the paying bank settles for the check, including the day of settlement.

■ 11. In § 229.38 paragraphs (b), (c), and (d) are revised to read as follows:

§ 229.38 Liability.

* * * * *

(b) *Paying bank's failure to make timely return.* If a paying bank fails both to comply with its expeditious return requirements under § 229.31(b) and with the deadline for return under the UCC, Regulation J (12 CFR part 210), or the extension of deadline under § 229.31(g) in connection with a single nonpayment of a check, the paying bank shall be liable under either § 229.31(b) or such other provision, but not both.

(c) *Comparative negligence.* If a person, including a bank, fails to exercise ordinary care or act in good faith under this subpart in indorsing a check (§ 229.35), accepting a returned check or notice of nonpayment (§ 229.33(b), (c), and (d)), or otherwise, the damages incurred by that person under § 229.38(a) shall be diminished in proportion to the amount of negligence or bad faith attributable to that person.

(d) *Responsibility for certain aspects of checks.* (1) A paying bank, or in the case of a check payable through the paying bank and payable by another bank, the bank by which the check is payable, is responsible for damages under paragraph (a) of this section to the extent that the condition of the check when issued by it or its customer adversely affects the ability of a bank to indorse the check legibly in accordance with § 229.35. A depositary bank is responsible for damages under paragraph (a) of this section to the extent that the condition of the back of a check arising after the issuance of the check and prior to acceptance of the check by it adversely affects the ability of a bank to indorse the check legibly in accordance with § 229.35. A reconverting bank is responsible for damages under paragraph (a) of this section to the extent that the condition of the back of a substitute check transferred, presented, or returned by it—

(i) Adversely affects the ability of a subsequent bank to indorse the check legibly in accordance with § 229.35; or

(ii) Causes an indorsement that previously was applied in accordance with § 229.35 to become illegible.

(2) Responsibility under this paragraph (d) shall be treated as negligence of the paying bank, depositary bank, or reconverting bank for purposes of paragraph (c) of this section.

* * * * *

■ 12. Section 229.39 is revised to read as follows:

§ 229.39 Insolvency of bank.

(a) *Duty of receiver to return unpaid checks.* A check or returned check in, or coming into, the possession of a paying

bank, collecting bank, depository bank, or returning bank that suspends payment, and which is not paid, shall be returned by the receiver, trustee, or agent in charge of the closed bank to the bank or customer that transferred the check to the closed bank.

(b) *Claims against banks for checks not returned by receiver.* If a check or returned check is not returned by the receiver, trustee, or agent in charge of the closed bank under paragraph (a) of this section, a bank shall have claims with respect to the check or returned check as follows:

(1) If the paying bank has finally paid the check, or if a depository bank is obligated to pay the returned check, and suspends payment without making a settlement for the check or returned check with the prior bank that is or becomes final, the prior bank has a claim against the paying bank or the depository bank.

(2) If a collecting bank, paying bank, or returning bank receives settlement from a subsequent bank for a check or returned check, which settlement is or becomes final, and suspends payments without making a settlement for the check with the prior bank, which is or becomes final, the prior bank has a claim against the collecting bank or returning bank.

(c) *Preferred claim against presenting bank for breach of warranty.* If a paying bank settles with a presenting bank for one or more checks, and if the presenting bank breaches a warranty specified in § 229.34(c)(1) or (3) with respect to those checks and suspends payments before satisfying the paying bank's warranty claim, the paying bank has a preferred claim against the presenting bank for the amount of the warranty claim.

(d) *Finality of settlement.* If a paying bank or depository bank gives, or a collecting bank, paying bank, or returning bank gives or receives, a settlement for a check or returned check and thereafter suspends payment, the suspension does not prevent or interfere with the settlement becoming final if such finality occurs automatically upon the lapse of a certain time or the happening of certain events.

■ 13. Section 229.40 is revised to read as follows:

§ 229.40 Effect of merger transaction.

For purposes of this subpart, two or more banks that have engaged in a merger transaction may be considered to be separate banks for a period of one year following the consummation of the merger transaction.

■ 14. Section 229.42 is revised to read as follows:

§ 229.42 Exclusions.

The expeditious return (§§ 229.31(b) and 229.32(b)), notice of nonpayment (§ 229.31(c)), and same-day settlement (§ 229.36(d)) requirements of this subpart do not apply to a check drawn upon the United States Treasury, to a U.S. Postal Service money order, or to a check drawn on a state or a unit of general local government that is not payable through or at a bank.

■ 15. In § 229.43, paragraphs (a)(2) and (b) are revised to read as follows:

§ 229.43 Checks payable in Guam, American Samoa, and the Northern Mariana Islands.

(a) * * *

(2) *Pacific island check* means—

(i) A demand draft drawn on or payable through or at a Pacific island bank, which is not a check as defined in § 229.2(k); and

(ii) An electronic image of, and electronic information derived from, a demand draft or returned demand draft drawn on or payable through or at a Pacific island bank that—

(A) Is sent to a receiving bank pursuant to an agreement between the sender and the receiving bank; and

(B) Conforms with ANS X9.100–187, unless the Board by rule or order determines that a different standard applies or the parties otherwise agree.

(b) *Rules applicable to Pacific island checks.* To the extent a bank handles a Pacific island check as if it were a check defined in § 229.2(k) or an electronic check defined in § 229.2(ggg), the bank is subject to the following sections of this part (and the word “check” in each such section is construed to include a Pacific island check)—

(1) Section 229.30(a) (Checks under this subpart), and (b) (Writings);

(2) Section 229.32 (Returning bank's responsibilities for return of checks) except that the returning bank is not subject to the requirement to return a Pacific Island check in an expeditious manner;

(3) Section 229.33(b) (Acceptance of electronic returned checks and electronic notices of nonpayment), (c) (Acceptance of paper returned checks and paper notices of nonpayment), § 229.33(d) (Acceptances of oral notices of nonpayment), § 229.33(e) (Payment), § 229.33(f) (Misrouted returned checks and written notices of nonpayment), § 229.33(g) (Charges);

(4) Section 229.34(a) (Warranties with respect to electronic checks and electronic returned checks), § 229.34(b) (Transfer and presentment warranties with respect to a remotely-created check), § 229.34(c)(2) (Cash letter total warranty), § 229.34(c)(3) (Encoding

warranty), § 229.34(f) (Remote deposit capture warranty), § 229.34(g) (Indemnities with respect to electronically-created items), § 229.34(h) (Damages), § 229.34(i) (Indemnity amounts), and § 229.34(j) (Tender of defense);

(5) Section 229.35 (Indorsements); for purposes of § 229.35(c) (Indorsement by a bank), the Pacific island bank is deemed to be a bank;

(6) Section 229.36(c) (Liability of bank during forward collection);

(7) Section 229.37 (Variation by agreement);

(8) Section 229.38 (Liability), except for § 229.38(b) (Paying bank's failure to make timely return);

(9) Section 229.39 (Insolvency of bank), except for § 229.39(c) (Preferred claim against presenting bank for breach of warranty); and

(10) Section 229.40 (Effect of merger transaction), § 229.41 (Relation to state law) and § 229.42 (Exclusions).

Subpart D—Substitute Checks

■ 16. In § 229.51, paragraphs (b)(2) through (3) are revised to read as follows:

§ 229.51 General provisions governing substitute checks.

* * * * *

(b) * * *

(2) Identifies the reconverting bank in a manner that preserves any previous reconverting-bank identifications, in accordance with ANS X9.100–140; and

(3) Identifies the bank that truncated the original check, in accordance with ANS X9.100–140.

* * * * *

■ 17. In § 229.52, paragraph (a) is revised to read as follows:

§ 229.52 Substitute check warranties.

(a) Content and provision of substitute-check warranties. (1) A bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check) for which it receives consideration warrants to the parties listed in paragraph (b) of this section that—

(i) The substitute check meets the requirements for legal equivalence described in § 229.51(a)(1) and (2); and

(ii) No depository bank, drawee, drawer, or indorser will receive presentment or return of, or otherwise be charged for, the substitute check, the original check, or a paper or electronic representation of the substitute check or original check such that that person will be asked to make a payment based on a check that it already has paid.

(2) A bank that rejects a check submitted for deposit and returns to its customer a substitute check (or a paper or electronic representation of a substitute check) makes the warranties in paragraph (a)(1) of this section regardless of whether the bank received consideration.

* * * * *

■ 18. In § 229.53, paragraph (a) is revised to read as follows:

§ 229.53 Substitute check indemnity.

(a) *Scope of indemnity.* (1) A bank that transfers, presents, or returns a substitute check or a paper or electronic representation of a substitute check for which it receives consideration shall indemnify the recipient and any subsequent recipient (including a collecting or returning bank, the depository bank, the drawer, the drawee, the payee, the depositor, and any indorser) for any loss incurred by any recipient of a substitute check if that loss occurred due to the receipt of a substitute check instead of the original check.

(2) A bank that rejects a check submitted for deposit and returns to its customer a substitute check (or a paper or electronic representation of a substitute check) shall indemnify the recipient as described in paragraph (a)(1) of this section regardless of whether the bank received consideration.

* * * * *

Appendix D to Part 229—[Removed and Reserved]

- 19. Appendix D to part 229 is removed and reserved.
- 20. In appendix E to part 229:
 - A. Under “II. Section 229.2 Definitions”:
 - i. Revise paragraph 2 under “Z. 229.2(z) Paying Bank”;
 - ii. Revise DD. 229(dd);
 - iii. Revise VV. 229.2(vv);
 - iv. Revise BBB. 229.2(bbb);
 - v. Add GGG. 229.2(ggg); and
 - vi. Add HHH. 229.2(hhh).
 - B. Revise XVI through XXVI and XXIX;
 - C. In “XXX. § 229.51 General provisions governing substitute checks,” revise paragraph B;
 - D. Revise XXXI;
 - E. In “XXXII. § 229.53 Substitute Check Indemnity,” paragraphs A, B.1., B.1. Examples, and B.3. are revised.
 - F. In “XXXIII. Section 229.54 Expedited Recredit for Consumers,” paragraph A.2. is revised.

The revisions and addition read as follows:

Appendix E to Part 229—Commentary

* * * * *

II. Section 229.2 Definitions

* * * * *

Z. 229.2(z) Paying Bank

* * * * *

2. Under § 229.31, a bank designated as a payable-through bank or payable-at bank and to which the check is sent for payment or collection is responsible for the expedited return of checks and notice of nonpayment requirements of Subpart C. The payable-through or payable-at bank may contract with the payor with respect to its liability in discharging these responsibilities. The Board believes that the EFA Act makes a clear connection between availability and the time it takes for checks to be cleared and returned. Allowing the payable-through bank additional time to forward checks to the payor and await return or pay instructions from the payor may delay the return of these checks, increasing the risks to depository banks. Subpart C of this part requires payable-through and payable-at banks to return a check expeditiously based on the time the payable-through or payable-at bank received the check for forward collection.

* * * * *

DD. 229.2(dd) Routing Number

1. Each bank is assigned a routing number by an agent of the American Bankers Association. The routing number takes two forms—a fractional form and a nine-digit form. A paying bank is identified by both the fractional form routing number (which normally appears in the upper right hand corner of the check) and the nine-digit form. The nine-digit form of the routing number of the paying bank generally is printed in magnetic ink near the bottom of the check (the MICR line; see ANS X9.13). In the case of an electronic check, the routing number of the paying bank is contained in the electronic image of the check (in nine-digit form and fractional form) and in the electronic information related to the check (in nine-digit form). When a check is payable by one bank but payable through another bank, the routing number appearing on the check is that of the payable-through bank, not the payor bank. Industry standards require depository banks, subsequent collecting banks, and returning banks to place their routing numbers in nine-digit form in their indorsements. (See § 229.35 and commentary thereto).

* * * * *

VV. 229.2(vv) MICR Line

1. Information in the MICR line of a check must be printed in accordance with ANS X9.13 for original checks and in accordance with ANS X9.100–140 for substitute checks, and must be contained in electronic checks in accordance with ANS X9.100–187. These standards could vary the requirements for printing the MICR line, such as by indicating circumstances under which the use of magnetic ink is not required. Banks that exchange checks electronically may agree to other standards for including MICR line

information in the checks that they exchange electronically.

* * * * *

BBB. 229.2(bbb) Sufficient Copy and Copy

1. A “copy” or a “sufficient copy” as defined in 229.2(bbb) must be a paper reproduction of a check, unless the parties sending and receiving the copy otherwise agree. Therefore, an electronic image of a check is not a “copy” or a “sufficient copy” absent an agreement to that effect. If a customer has agreed to receive such information electronically, however, a bank that is required to provide a copy or sufficient copy may satisfy that requirement by providing an electronic image. (See § 229.58).

2. A sufficient copy, which is used to resolve claims related to the receipt of a substitute check, must be a copy of the original check.

3. A bank under § 229.53(b)(3) may limit its liability for an indemnity claim and under §§ 229.54(e)(2) and 229.55(c)(2) may respond to an expedited recredit claim by providing the claimant with a copy of a check that accurately represents all of the information on the front and back of the original check as of the time the original check was truncated or that otherwise is sufficient to determine the validity of the claim against the bank.

Examples

a. A copy of an original check that accurately represents all the information on the front and back of the original check as of the time of truncation would constitute a sufficient copy if that copy resolved the claim. For example, if resolution of the claim required accurate payment and indorsement information, an accurate copy of the front and back of a legible original check (including but not limited to a substitute check) would be a sufficient copy.

b. A copy of the original check that does not accurately represent all the information on both the front and back of the original check also could be a sufficient copy if such copy contained all the information necessary to determine the validity of the relevant claim. For instance, if a consumer received a substitute check that contained a blurry image of a legible original check, the consumer might seek an expedited recredit because his or her account was charged for \$1,000, but he or she believed that the check was written for only \$100. If the amount that appeared on the front of the original check was legible, an accurate copy of only the front of the original check that showed the amount of the check would be sufficient to determine whether or not the consumer’s claim regarding the amount of the check was valid.

* * * * *

GGG. 229.2(ggg) Electronic Check and Electronic Returned Check

1. Banks often enter into agreements under which a check may be transferred, returned, or presented electronically instead of transferring, returning, or presenting the paper check. For example, an agreement may provide that either an electronic image of the

check or electronic information related to the check may be sent instead of the paper check. In order to satisfy Regulation CC's definition of "electronic check" (or "electronic returned check"), however, both the electronic image of the check and electronic information derived from the check must be sent. A sending bank and receiving bank may also agree, for example, that instead of sending the electronic check or electronic returned check directly to the receiving bank, the electronic check or electronic returned check may be sent to an intermediary that stores the electronic check or electronic returned check on the receiving bank's behalf and makes the electronic check or electronic returned check available for the receiving bank to retrieve.

2. A sending bank must have an agreement with the receiving bank in order to send an electronic check instead of a paper check. The agreement to receive an electronic check or electronic returned check may be either bilateral or through a Federal Reserve Bank operating circular, clearinghouse rule, or other interbank agreement. (See UCC 4-110).

3. ANS X9.100-187 is the most prevalent industry standard for electronic checks and electronic returned checks that will enable banks to create substitute checks. Multiple standards, however, exist that would enable a bank to create a substitute check from an electronic check. Therefore, the banks exchanging electronic checks may agree that a different standard applies to electronic checks exchanged between the two banks. Additionally, banks that exchange checks electronically may agree to transfer, present, or return only electronic images of checks or only electronic information related to checks. In these situations, the sending bank and receiving bank will have agreed to a different standard as ANS X9.100-187 requires both an electronic image and electronic information.

4. Electronic checks and electronic returned checks as defined in Regulation CC are subject to subpart C, except as otherwise provided in that subpart. (See § 229.30 and commentary thereto).

HHH. 229.2(hhh) Electronically-Created Item

1. Electronically-created items are also sometimes referred to in the industry as "electronic payment orders" or "EPOs."

2. Because an electronically-created item as defined in Regulation CC never existed in paper form, it does not meet the definition of "electronic check" in 229.2(ggg) and therefore an electronically-created item cannot be used to create a substitute check that is the legal equivalent of the original paper check.

3. An electronically-created item can resemble an electronic image of a paper check or an electronic image of a remotely created check. (See 229.2(fff) (definition of remotely created check)).

Examples

a. A corporate customer of a bank, rather than printing and mailing a paper check to a payee, electronically creates an image that looks like an image of the corporate customer's paper checks and emails the image to the payee.

b. A consumer uses a smart-phone application through which the consumer

provides the payee name, amount, and the consumer's signature. The application electronically sends this information, appearing formatted as a check, to the payee.

c. A consumer calls his utility company to make an emergency bill payment, and provides his bank account information. The utility company uses this information to create an electronically-created item and deposits the electronically-created item with its bank to obtain payment from the consumer.

* * * * *

XVI. Section 229.30 Electronic Checks and Electronic Information

A. 229.30(a) Checks Under This Subpart

1. A bank may agree to receive an electronic check or electronic returned check from another bank instead of a paper check or returned check. (See § 229.2(bbb) and commentary thereto). Section 229.30(a) does not give a bank the right to send an electronic check or electronic returned check absent an agreement to do so with the receiving bank.

2. Electronic checks and electronic returned checks are subject to subpart C of this part as if they were checks or returned checks, unless otherwise provided in subpart C. For example, § 229.31(c), which requires a paying bank to provide a notice of nonpayment if the paying bank determines not to pay a check in the amount of \$5,000 or more, also applies when a paying bank determines not to pay an electronic check in the amount of \$5,000 or more. A depositary bank's obligation to pay for a returned check (§ 229.33(e)) also applies with respect to an electronic returned check.

Additionally, §§ 229.33(b) and 229.36(a) specify that the parties' agreements govern the receipt of electronic returned checks and electronic written notices of nonpayment, and electronic checks, respectively. Section 229.34(a) sets forth warranties that are given only with respect to electronic checks and electronic returned checks and section 229.34(f) sets forth an indemnity given only with respect to remote deposit capture. Warranties that apply to paper checks or paper returned checks also apply to electronic checks and electronic returned checks, including § 229.34(b) (transfer and presentment warranties with respect to remotely created checks), § 229.34(c) (settlement amount, encoding, and offset warranties), § 229.34(d) (returned check warranties), and § 229.34(e) (notice of nonpayment warranties). The parties may, by agreement, vary the effect of the provisions in subpart C of this part as they apply to electronic checks and electronic returned checks, except that as set forth in § 229.37, no agreement can disclaim the responsibility of a bank for its own lack of good faith or failure to exercise ordinary care. (See § 229.37 and commentary thereto).

3. Certain provisions of subpart C relate solely to paper checks or paper returned checks, as specified, such as § 229.33(c) (acceptance of paper returned checks) and § 229.36(d) (same-day settlement).

B. 229.30(b) Writings

1. Provisions in subpart C of this part require that a paying bank or returning bank

send information in writing. For example, § 229.31(f) requires that a notice in lieu be either a copy of the check or a written notice of nonpayment. A bank may send information required to be in writing in electronic form if the bank sending the information has an agreement with the bank receiving the information to do so.

XVII. Section 229.31 Paying Bank's Responsibility for Return of Checks and Notices of Nonpayment

A. 229.31(a) Return of Checks

1. Routing of returned checks.
a. This subsection is subject to the requirements of expeditious return provided in § 229.31(b).

b. The paying bank acts, in effect, as an agent or subagent of the depositary bank in selecting a means of return. Under § 229.31(a), a paying bank is authorized to route the returned check in a variety of ways:

i. It may send the returned check directly to the depositary bank by sending an electronic returned check directly to the depositary bank if the paying bank has an agreement with the depositary bank to do so, or by using a courier or other means of delivery, bypassing returning banks; or
ii. It may send the returned check or electronic returned check to any returning bank agreeing to handle the returned check or electronic returned check, regardless of whether or not the returning bank handled the check for forward collection.

c. If the paying bank elects to return the check directly to the depositary bank, it is not necessarily required to return the check to the branch of first deposit. A paper check may be returned to the depositary bank at any physical location permitted under § 229.33(c).

2. a. In some cases, a paying bank will be unable to identify the depositary bank through the use of ordinary care and good faith. These cases are now rare as depositary banks generally apply their indorsements electronically. A paying bank, for example, would be unable to identify the depositary bank if the depositary bank's indorsement is neither in an addenda record nor within the image of the check that was presented electronically. A paying bank, however, would not be "unable" to identify the depositary bank merely because the depositary bank's indorsement is available within the image rather than attached as an addenda record.

b. In cases where the paying bank is unable to identify the depositary bank, the paying bank may send the returned check to a returning bank that agrees to handle the returned check. The returning bank may be better able to identify the depositary bank.

c. In the alternative, the paying bank may send the check back up the path used for forward collection of the check. The presenting bank and prior collecting banks normally will be able to trace the collection path of the check through the use of their internal records in conjunction with the indorsements on the returned check. In these limited cases, the presenting bank or a prior collecting bank is required to accept the returned check and send it to another prior collecting bank in the path used for forward

collection or to the depository bank. If the paying bank has an agreement to send electronic returned checks to a bank that handled the check for forward collection, the paying bank may send the electronic returned check to that bank.

d. A paying bank returning a check to a prior collecting bank because it is unable to identify the depository bank must advise that bank that it is unable to identify the depository bank. This advice must be conspicuous, such as a stamp on each check for which the depository bank is unknown if such checks are commingled with other returned checks, or, if such checks are sent in a separate cash letter, by one notice on the cash letter. In the case of an electronic returned check, the advice requirement may be satisfied as agreed to by the parties. The advice will warn the bank that this check will require special research and handling in accordance with § 229.32(a)(2). The returned check may not be prepared as a qualified return.

e. A paying bank also may send a check to a prior collecting bank to make a claim against that bank under § 229.35(b) where the depository bank is insolvent or in other cases as provided in § 229.35(b). Finally, a paying bank may make a claim against a prior collecting bank based on a breach of warranty under UCC 4-208.

3. Midnight deadline. Except for the extension permitted by § 229.31(g), discussed below, this section does not relieve a paying bank from the requirement for timely return (*i.e.*, midnight deadline) under UCC 4-301 and 4-302, which continue to apply. Under UCC 4-302, a paying bank is “accountable” for the amount of a demand item, other than a documentary draft, if it does not pay or return the item or send notice of dishonor by its midnight deadline. Under UCC 3-418(c) and 4-215(a), late return constitutes payment and would be final in favor of a holder in due course or a person who has in good faith changed his position in reliance on the payment. Thus, the UCC midnight deadline gives the paying bank an incentive to make a prompt return.

4. UCC provisions affected. This paragraph directly affects the following provisions of the UCC, and may affect other sections or provisions:

a. Section 4-301(d), in that instead of returning a check through a clearinghouse or to the presenting bank, a paying bank may send a returned check to the depository bank or to a returning bank.

b. Section 4-301(a), in that settlement for returned checks is made under § 229.32(e), not by revocation of settlement.

B. 229.31(b) *Expeditious Return of Checks*

1. This section requires a paying bank (which, for purposes of subpart C, may include a payable-through and payable-at bank (see § 229.2(z)) that determines not to pay a check to return the check expeditiously. Section 229.31(d) sets forth exceptions to this general rule. If a paying bank is not subject to the requirement for expeditious return under § 229.31(b), the paying bank, nonetheless, must return the check within its deadlines under the UCC, Regulation J (12 CFR part 210) or

§§ 229.36(d)(3) and (f)(4), as extended by § 229.31(g), for returning the item or sending notice.

2. Two-Day Test

a. A returned check, including the original check, substitute check, or electronic returned check, is returned expeditiously if a paying bank sends the returned check in a manner such that the returned check would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank.

b. A paying bank may satisfy its expeditious return requirement by returning either an electronic returned check or a paper check. For example, a paying bank could meet the expeditious return test by sending an electronic returned check directly to the depository bank, if the paying bank has an agreement with the depository bank to do so, such that it normally would reach the depository bank by the specified deadline, or sending an electronic returned check to a returning bank, if the paying bank has an agreement with the returning bank to do so, within the returning bank's timeframe for delivering electronic returned checks to the depository bank within the return deadline. A paying bank that sends a returned check in paper form would typically need a highly expeditious means of delivery to meet the expeditious return test.

c. This test does not require actual receipt of the returned check by the depository bank within the specified deadline. In determining whether an electronic returned check would normally reach a depository bank within the specified deadline, a paying bank may rely on a returning bank's return deadlines and availability schedules for electronic returned checks and returned checks destined for the depository bank. A paying bank may not rely on the availability schedules if the paying bank has reason to believe that these schedules do not reflect the actual time for return of an electronic returned check to the depository bank to which the paying bank is returning the check. The paying bank is not responsible for unforeseeable delays in the return of the check, such as communication failures or transportation delays.

d. Where the second business day following presentment of the check to the paying bank is not a banking day for the depository bank, the depository bank might not process checks on that day. Consequently, if the last day of the time limit is not a banking day for the depository bank, the check may be delivered to the depository bank not later than 2 p.m. (local time of the depository bank) on the depository bank's next banking day and the return will still be considered expeditious.

e. Paying banks and returning banks are subject to the expeditious return rule, however, under section 229.33(a) a paying or returning bank may be liable to a depository bank for failing to return a check in an expeditious manner only if the depository bank has arrangements in place such that the paying or returning bank could return a returned check to the depository bank electronically by commercially reasonable means. The depository bank has the burden

of proof for demonstrating that its arrangements are commercially reasonable.

3. Examples

a. The paying bank and depository bank have a bilateral agreement under which the depository bank agrees to receive electronic returned checks directly from the paying bank. If a check is presented to a paying bank on Monday, the paying bank should send the returned check such that an electronic returned check normally would be received by the depository bank by 2 p.m. (local time of the depository bank) on Wednesday. This result is the same if, instead of a bilateral agreement, the paying bank and depository bank are members of the same clearinghouse and agree to exchange electronic returned checks under clearinghouse rules.

b. The depository bank has an agreement to receive electronic returned checks from Returning Bank A but not from the paying bank. The paying bank, however, has an agreement with Returning Bank A to send electronic returned checks to Returning Bank A. If a check is presented to the paying bank on Monday, the paying bank should send the returned check such that the depository bank normally would receive the returned check by 2 p.m. (local time of the depository bank) on Wednesday. A paying bank may satisfy this requirement by sending either an electronic returned check or a paper returned check to Returning Bank A in a manner that permits Returning Bank A to send an electronic returned check to the depository bank by 2 p.m. on Wednesday. The paying bank may also send a paper returned check to the depository bank if a paper returned check would normally be received by the depository bank by 2 p.m. on Wednesday.

c. The paying bank has an agreement to send electronic returned checks to Returning Bank A. The depository bank has an agreement to receive electronic returned checks from Returning Bank B. The paying bank does not have an agreement to send electronic returned checks to Returning Bank B. Returning Bank A, however, has an agreement to send electronic returned checks to Returning Bank B. If a check is presented to the paying bank on Monday, the paying bank should send the returned check such that the depository bank normally would receive the returned check by 2 p.m. (local time of the depository bank) on Wednesday.

C. 229.31(c) *Notice of Nonpayment*

1. Requirement

a. The paying bank must send a notice of nonpayment if it decides not to pay a check in the amount of \$5,000 or more. Except in the case where the returned check or a notice in lieu of return serves as the notice of nonpayment, the notice of nonpayment carries no value, and the check or substitute check must be returned in addition to the notice of nonpayment. The paying bank must send the notice of nonpayment such that it would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following presentment. In determining whether the notice requirement is satisfied, the paying bank may rely on the availability schedules of a third party that

provides the notice on behalf of the paying bank as the time that the notice is expected to be delivered to the depository bank, unless the paying bank has reason to know the availability schedules are inaccurate.

b. A bank identified by routing number as the paying bank is considered the paying bank under this subpart and would be required to provide a notice of nonpayment even though that bank determined that the check was not drawn by a customer of that bank. (See commentary to the definition of paying bank in § 229.2(z)). A bank designated as a payable-through or payable-at bank and to which the check is sent for payment or collection is responsible for the notice of nonpayment requirement. The payable-through or payable-at bank may contract with the payor with respect to its liability in discharging these responsibilities.

c. The paying bank should not send a notice of nonpayment until it has finally determined not to pay the check. Under § 229.34(e), by sending the notice the paying bank warrants that it has returned or will return the check. If a paying bank sends a notice and subsequently decides to pay the check, the paying bank may mitigate its liability on this warranty by notifying the depository bank that the check has been paid.

d. The return of the check itself may serve as the required notice of nonpayment. In some cases, the returned check may be received by the depository bank within the time requirements of § 229.31(c)(1) and no notice other than the return of the check will be necessary. If the check is not received by the depository bank within the time limits for notice, the return of the check may not satisfy the notice requirement. In determining whether the returned check will satisfy the notice requirement, the paying bank may rely on the availability schedules of returning banks as the time that the returned check is expected to be delivered to the depository bank, unless the paying bank has reason to know the availability schedules are inaccurate.

e. The requirement for notice does not affect the requirements for return of the check under the UCC (or § 229.31(b)). A paying bank is not responsible for failure to give notice of nonpayment to a party that has breached a presentment warranty under UCC 4-208, notwithstanding that the paying bank may have returned the check. (See UCC 4-208 and 4-302).

2. Content of Notices

a. This paragraph provides that, to the extent the information is available to the paying bank, the notice must at a minimum contain the information contained in the check's MICR line when the check was received by the paying bank. The MICR line information includes the paying bank's routing number, the account number of the paying bank's customer, the check number, and auxiliary on-us fields for corporate checks, and may include the amount of the check.

b. Although it has no duty to do so, a paying bank that cannot identify the depository bank from the check itself may wish to send the notice to the earliest collecting bank it can identify and indicate that the notice is not being sent to the

depository bank. The collecting bank may be able to identify the depository bank and forward the notice, but is under no duty to do so. In addition, the collecting bank may actually be the depository bank.

c. A bank must identify an item of information if the bank is uncertain as to that item's accuracy. A bank may make this identification in accordance with general industry practices, or by other reasonable means. For example, where the paying bank receives a handwritten check with a payee name that the paying bank cannot decipher using a good faith effort, the paying bank could include a "?" symbol in the payee's name field of the notice to indicate its uncertainty as to that particular element.

D. 229.31(d) Exceptions to the Expeditious Return of Checks and Notice of Nonpayment

1. Depository Banks Not Subject to Subpart B of This Part

a. Subpart B of this part applies only to "checks" deposited in transaction "accounts." A depository bank with only time or savings accounts or credit card accounts need not comply with the availability requirements of subpart B of Regulation CC. Thus, the expeditious return requirement of § 229.31(b) and the notice of nonpayment requirement of § 229.31(c) do not apply to checks being returned to banks that do not hold accounts. The paying bank's midnight deadline in UCC 4-301 and 4-302 and § 210.12 of Regulation J (12 CFR 210.12), and the extension in § 229.31(g), would continue to apply to these checks.

b. The expeditious return requirement and the notice of nonpayment requirement apply only to "checks" deposited in a bank that is a "depository institution" under the EFA Act. Federal Reserve Banks, Federal Home Loan Banks, private bankers, and possibly certain industrial banks are not "depository institutions" within the meaning of the EFA Act and therefore are not subject to the expedited-availability requirements of subpart B of this regulation. Thus, the expeditious return and notice of nonpayment requirements of this section would not apply to a paying bank returning a check that was deposited in one of these banks.

2. Unidentifiable Depository Banks

a. A paying bank that sends a check to a bank that handled the check for forward collection because the paying bank is unable to identify the depository bank is not subject to the requirement for expeditious return by the paying bank or to the requirement for notice of nonpayment. Although the lack of requirement for notice of nonpayment under this paragraph will create risks for the depository bank, the inability to identify the depository bank will generally be due to the depository bank's, or a collecting bank's, failure to indorse as required by § 229.35(a). If the depository bank failed to use the proper indorsement, it should bear the risks of less-than-expeditious return or not receiving notice of nonpayment in a timely manner. Similarly, where the inability to identify the depository bank is due to indorsements or other information placed on the back of the check by the depository bank's customer or other prior indorser, the depository bank

should bear the risk that it cannot charge a returned check back to that customer.

b. This paragraph does not relieve a paying bank from the liability for the lack of expeditious return or not providing notice of nonpayment in cases where the paying bank is itself responsible for the inability to identify the depository bank, such as when the paying bank's customer has used a check with printing or other material on the back in the area reserved for the depository bank's indorsement, and the depository bank placed its indorsement on the original check making the indorsement unreadable. (See § 229.38(c)).

c. A paying bank's return of a check to an unidentifiable depository bank is subject to its midnight deadline under UCC 4-301, Regulation J (if the check is returned through a Federal Reserve Bank), and the extension provided in § 229.31(g).

E. 229.31(e) Identification of Returned Check

1. The reason for the return must be clearly indicated. A check is identified as a returned check if the front of that check indicates the reason for return, even though it does not specifically state that the check is a returned check. A reason such as "Refer to Maker" may be appropriate in certain cases, such as when a drawer with a positive pay arrangement instructs the bank to return the check. By contrast, a reason such as "Refer to Maker" would be inappropriate in cases where a check is being returned due to the paying bank having already paid the item, where a check has been altered, or where a check is unauthorized. In such cases, the payee and not the drawer would generally have more information as to why the check is being returned.

2. If the returned check is a substitute check or electronic returned check, the reason for return information must be included such that it is retained on any subsequent substitute check. For substitute checks, this requirement could be met by placing the information (1) in the location on the front of the substitute check that is specified by ANS X9.100-140 or (2) within the image of the original check that appears on the front of the substitute check so that the information is retained on any subsequent substitute check. For electronic returned checks, this requirement could be met by including the reason for return in accordance with ANS X9.100-187. If the paying bank places the returned check in a carrier envelope, the carrier envelope should indicate that it is a returned check but need not repeat the reason for return stated on the check if it in fact appears on the check.

F. 229.31(f) Notice in Lieu of Return

1. A notice in lieu of return may be used by a bank handling a returned check that has been lost or destroyed, including when the original returned check has been charged back as lost or destroyed as provided in § 229.35(b). Notice in lieu of return is permitted only when a bank does not have and cannot obtain possession of the check (or must retain possession of the check for protest) and does not have sufficient information to create a substitute check. For example, a bank that does not have the

original check may have an image of both sides of the check, but the image may be insufficient or may not be in the proper format such that the bank cannot create a substitute check or provide required substitute check warranties. In that case, the check would be unavailable for return. A bank using a notice in lieu of return gives a warranty under § 229.34(d)(1)(iv) that the check, in any form, has not been and will not be returned.

2. A notice in lieu of return must be in writing (either in paper form, or if agreed to by the parties electronic form), but not provided by telephone or other oral transmission. The requirement for a writing and the indication that the notice is a substitute for the returned check is necessary so that any returning bank and the depository bank are informed that the notice carries value. A check that is lost or otherwise unavailable for return may be returned by sending a legible copy of both sides of the check or, if such a copy is not available to the paying bank, a written notice of nonpayment containing the information specified in § 229.31(c)(2). The copy or written notice must clearly indicate it is a notice in lieu of return. Notice by a legible facsimile of both sides of the check may satisfy the requirements for a notice in lieu of return.

The paying bank may send an electronic image of both sides of the check as a notice in lieu of return only if it has an agreement to do so with the receiving bank. (See § 229.30(b)).

3. The requirement of this paragraph supersedes the requirement of UCC 4–301(a) as to the form and information required of a notice of dishonor or nonpayment.

4. The notice in lieu of return is subject to the provisions of this subpart relating to returned checks and is treated like a returned check for purposes of this subpart. Reference in the regulation and this commentary to a returned check includes a notice in lieu of return unless the context indicates otherwise.

5. If not all of the information required by § 229.31(c)(2) is available, the paying bank may make a claim against any prior bank handling the check as provided in § 229.35(b).

G. 229.31(g) Extension of Deadline

1. This paragraph permits extension of the deadlines in the UCC, Regulation J (12 CFR part 210), and § 229.36(d)(3) and (4) for returning a check for which the paying bank previously has 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 § 210.9 of Regulation J (12 CFR part 210), or § 229.36(d)(3) or (4)), in two circumstances:

a. A paying bank may, by agreement, send an electronic returned check instead of a paper returned check or 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 midnight deadline for

returned checks if the returned check reaches the depository bank (or receiving bank, if the depository bank is unidentifiable) on or before the depository bank's (or receiving bank's) next banking day following the otherwise applicable deadline by the earlier of the close of that banking day or a cutoff hour of 2 p.m. (local time of the depository bank or receiving bank) or later set by the depository bank (or receiving bank) under UCC 4–108. This paragraph applies to the extension of all midnight deadlines except Saturday midnight deadlines (see the following paragraph).

b. A paying bank may observe a banking day, as defined in the applicable UCC, on a Saturday, which is not a business day and therefore not a banking day under Regulation CC. 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. However, the bank may not have its back-office operations staff available on Saturday to prepare and send the electronic returned checks, and the returning bank or depository bank that would be receiving this electronic information may not have staff available to process it until Sunday night or Monday morning. This paragraph extends the midnight deadline if the returned checks reach the returning bank by a cut-off hour (usually on Sunday night or Monday morning) that permits processing during its next processing cycle or reach the depository bank (or receiving bank) by the cut-off hour on its next banking day following the Saturday midnight deadline. This paragraph applies exclusively to the extension of Saturday midnight deadlines.

2. 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 4–301 and 4–302, §§ 210.9 and 210.12 of Regulation J (12 CFR 210.9 and 210.12), and § 229.36(d)(3) and (4).

3. If the paying bank has an agreement to do so with the receiving bank (such as through bilateral agreements, clearinghouse rules, or operating circular), the paying bank may satisfy its midnight or other return deadline by sending an electronic returned check prior to the expiration of the deadline. The time when the electronic returned check is considered to be received by the depository bank is determined by the agreement. The paying bank satisfies its midnight or other return deadline by dispatching paper returned checks to another bank by courier, including a courier under contract with the paying bank, prior to expiration of the deadline.

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

H. 229.31(h) Payable Through and Payable at Checks

1. For purposes of subpart C of this part, the regulation defines a payable-through or payable-at bank (which could be designated

the collectible-through or collectible-at bank) as a paying bank. The requirements of subpart C are imposed on a payable-through or payable-at bank and are based on the time of receipt of the forward collection check by the payable-through or payable-at bank. This provision is intended to speed the return of checks and receipt of notices of nonpayment for checks that are payable through or at a bank to the depository bank.

2. A check sent for payment or collection to a payable-through or payable-at bank is not considered to be drawn on that bank for purposes of the midnight deadline provision of UCC 4–301.

I. 229.31(i) Reliance on Routing Number

1. Although § 229.35 requires that the depository bank indorsement contain its nine-digit routing number, it is possible that a returned check will bear the routing number of the depository bank in fractional, nine-digit, or other form. This paragraph permits a paying bank to rely on the routing number of the depository bank as it appears on the check (in the depository bank's indorsement) or in the electronic check sent pursuant to an agreement when the check, or electronic check, is received by the paying bank.

2. If there are inconsistent routing numbers, the paying bank may rely on any routing number designating the depository bank. The paying bank is not required to resolve the inconsistency prior to processing the check. The paying bank remains subject to the requirement to act in good faith and use ordinary care under § 229.38(a).

XVIII. Section 229.32 Returning Bank's Responsibility for Returned Checks

A. 229.32(a) Return of Checks

1. Routing of Returned Check

a. Under § 229.32(a), the returning bank is authorized to route the returned check in a variety of ways:

i. It may send the returned check directly to the depository bank by sending an electronic returned check directly to the depository bank if the returning bank has an agreement with the depository bank to do so, or by using a courier or other means of delivery; or

ii. It may send the returned check or electronic returned check to any returning bank agreeing to handle the returned check regardless of whether or not the returning bank handled the check for forward collection.

b. If the returning bank elects to send the returned check directly to the depository bank, it is not required to send the check to the branch of the depository bank that first handled the check. A paper returned check may be sent to the depository bank at any physical location permitted under § 229.33(b).

2. Unidentifiable Depository Bank

a. Returning banks agreeing to handle checks for return to depository banks under § 229.32(a) are expected to be expert in identifying depository bank indorsements. In the limited cases where the returning bank cannot identify the depository bank, if the returning bank did not handle the check for

forward collection, it may send the returned check to any collecting bank that handled the check for forward collection.

b. If, on the other hand, the returning bank itself handled the check for forward collection, it may send the returned check to a collecting bank that was prior to it in the forward-collection process, which will be better able to identify the depository bank. If there are no prior collecting banks, the returning bank must research the collection of the check and identify the depository bank.

c. The returning bank's return of a check under this paragraph is subject to the requirement to use ordinary care under UCC 4-202(b). (See definition of returning bank in § 229.2(cc)).

d. As in the case of a paying bank returning a check under § 229.31(a)(2), a returning bank returning a check under § 229.32(a)(2) must advise the bank to which it sends the returned check that it is unable to identify the depository bank. This advice must be conspicuous, such as a stamp on the check or a notice on the cash letter. The returned check may not be prepared as a qualified return. In the case of an electronic returned check, the advice requirement may be satisfied as agreed to by the parties.

3. A returning bank agrees to handle a returned check if it—

a. Publishes or distributes availability schedules for the return of returned checks and accepts the returned check for return;

b. Handles a returned check for return that it did not handle for forward collection;

c. Agrees with the paying bank or returning bank to handle electronic returned checks sent by that bank; or

d. Otherwise agrees to handle a returned check.

4. *Cut-off hours.* A returning bank may establish earlier cut-off hours for receipt of returned checks than for receipt of forward collection checks, but, unless the sending bank and returning bank agree otherwise, the cut-off hour for returned checks may not be earlier than 2 p.m. (local time of the returning bank). The returning bank also may set different sorting requirements for returned checks than those applicable to other checks. Thus, a returning bank may allow itself more processing time for returns than for forward collection checks.

5. *Qualified returned checks.* A qualified returned check will be handled by subsequent returning banks more efficiently than a raw return. The qualified returned check must include the routing number of the depository bank, the amount of the check, and a return identifier encoded on the check in magnetic ink. A check that is converted to a qualified returned check must be encoded in accordance with ANS X9.13 for original checks or ANS X9.100-140 for substitute checks. If the returning bank makes an encoding error in creating a qualified returned check, it may be liable under § 229.38 for losses caused by any negligence or under § 229.34(c)(3) for breach of an encoding warranty.

6. *Responsibilities of returning bank.* In meeting the requirements of this section, the returning bank is responsible for its own actions, but not those of the paying bank,

other returning banks, or the depository bank. (See UCC 4-202(c) regarding the responsibility of collecting banks).

7. *UCC sections affected.* Section 229.32 directly affects UCC Section 4-214(a) and may affect other sections or provisions. (See UCC 4-202(b)). Section 4-214(a) is affected in that settlement for returned checks is made under § 229.32(e) and not by charge-back of provisional credit.

B. 229.32(b) Expeditious Return of Checks

1. The standards for return of checks established by this section are similar to those for paying banks in § 229.31(b). This section requires a returning bank to return a returned check expeditiously, subject to the exceptions set forth in § 229.32(c). In effect, the returning bank is an agent or subagent of the paying bank and a subagent of the depository bank for the purposes of returning the check.

2. A returning bank that agrees to handle a returned check (see commentary to § 229.32(a)) is subject to the expeditious return requirement with respect to the returned check except as provided in § 229.32(c).

3. *Two-day test.* As in the case of a paying bank, a returning bank's return of a returned check is expeditious if it is sent in a manner such that the depository bank would normally receive the returned check by 2 p.m. (local time of the depository bank) of the second business day after the banking day on which the check was presented to the paying bank. Although a returning bank will not have firsthand knowledge of the day on which a check was presented to the paying bank, returning banks may, by agreement, allocate with paying banks liability for late return based on the delays caused by each. Paying banks and returning banks are subject to the expeditious return rule, however, under section 229.33(a) a paying or returning bank may be liable to a depository bank for failing to return a check in an expeditious manner only if the depository bank has arrangements in place such that the paying bank or returning bank could return a returned check to the depository bank electronically by commercially reasonable means. The depository bank has the burden of proof for demonstrating that its arrangements are commercially reasonable.

4. *Example.* Returning Bank A does not have an agreement to send electronic returned checks to the depository bank but has an agreement to send electronic returned checks to Returning Bank B, which, in turn, has an agreement to send electronic returned checks to the depository bank. If a check is presented to the paying bank on Monday, each returning bank would need to send the returned check in a manner such that the depository bank normally would receive the returned check by 2 p.m. (local time of the depository bank) on Wednesday.

C. 229.32(c) Exceptions to the Expeditious Return of Checks

1. This paragraph sets forth the circumstances under which a returning bank is not required to return the check to the depository bank in accordance with § 229.32(b).

2. Depository bank not subject to subpart B. This paragraph is similar to § 229.31(d)(1) and relieves a returning bank of its obligation to make expeditious return to a depository bank that does not hold "accounts" under subpart B of this regulation or is not a "depository institution" within the meaning of the EFA Act. (See commentary to § 229.31(d)).

3. Unidentifiable depository bank. A returning bank is not subject to the expeditious return requirements of § 229.32(b) in handling a returned check for which the paying bank cannot identify the depository bank.

4. Misrouted returned check. A returning bank is not subject to the expeditious return requirements of § 229.32(b) in handling a misrouted returned check pursuant to § 229.33(f). A bank acting as a returning bank because it received a returned check on the basis that it was the depository bank and sends the misrouted returned check to the correct depository bank, directly or through subsequent returning banks, is similarly not subject to the expeditious return requirements of § 229.32(b). (See commentary to § 229.33(f)).

D. 229.32(d) Notice in Lieu of Return

1. This paragraph is similar to § 229.31(f) and authorizes a returning bank to originate a notice in lieu of return if the returned check is unavailable for return. Notice in lieu of return is permitted only when a bank does not have and cannot obtain possession of the check (or when the bank must retain possession of the check for protest) and does not have sufficient information to create a substitute check. (See commentary to § 229.31(f)).

E. 229.32(e) Settlement

1. Under the UCC, a paying bank settles with a presenting bank after the check is presented to the paying bank. The paying bank may recover the settlement when the paying bank returns the check to the presenting bank. Under this regulation, however, the paying bank may return the check directly to the depository bank or through returning banks that did not handle the check for forward collection. On these more efficient return paths, the paying bank does not recover the settlement made to the presenting bank. Thus, this paragraph requires the returning bank to settle for a returned check (either with the paying bank or another returning bank) in the same way that it would settle for a similar check for forward collection. To achieve uniformity, this paragraph applies even if the returning bank handled the check for forward collection.

2. Any returning bank, including one that handled the check for forward collection, may provide availability for returned checks pursuant to an availability schedule as it does for forward collection checks. These settlements by returning banks, as well as settlements between banks made during the forward collection of a check, are considered final when made subject to any deferment of availability. (See § 229.36(c) and commentary to § 229.35(b)).

3. A returning bank may vary the settlement method it uses by agreement with

paying banks or other returning banks. Special rules apply in the case of insolvency of banks. (See § 229.39). If payment cannot be obtained from a depository bank or returning bank because of its insolvency or otherwise, recovery can be had by returning banks, paying banks, and collecting banks from prior banks on this basis of the liability of prior banks under § 229.35(b).

4. This paragraph affects UCC 4–214(a) in that a paying bank or collecting bank does not ordinarily have a right to charge back against the bank from which it received the returned check, although it is entitled to settlement if it returns the returned check to that bank, and may affect other sections or provisions. Under § 229.36(c), a bank collecting a check remains liable to prior collecting banks and the depository bank's customer under the UCC.

F. 229.32(f) Charges

1. This paragraph permits any returning bank, even one that handled the check for forward collection, to impose a fee on the paying bank or other returning bank for its service in handling a returned check. Where a claim is made under § 229.35(b), the bank on which the claim is made is not authorized by this paragraph to impose a charge for taking up a check. This paragraph preempts state laws to the extent that these laws prevent returning banks from charging fees for handling returned checks.

G. 229.32(g) Reliance on Routing Number

1. This paragraph is similar to § 229.31(i) and permits a returning bank to rely on routing numbers appearing on a returned check such as routing numbers in the depository bank's indorsement, or in the electronic returned check received by the returning bank pursuant to an agreement, or on qualified returned checks. (See commentary to § 229.31(i)).

XIX. Section 229.33 Depository Bank's Responsibility for Returned Checks and Notices of Nonpayment

A. 229.33(a) Right To Assert Claim

1. This paragraph sets forth the circumstances under which a paying bank or returning bank may be liable to a depository bank for failing to return a check in an expeditious manner in accordance with §§ 229.31(b) and 229.32(b) respectively.

2. This paragraph does not require a depository bank to establish arrangements to accept returned checks electronically, either directly from the paying bank or indirectly from a returning bank. Most depository banks, however, have arrangements in place to accept returned checks electronically. (See commentary to §§ 229.31(b) and 229.32(b) for examples of direct and indirect arrangements).

3. The depository bank has the burden of proof for demonstrating that its arrangements for accepting returned checks electronically are commercially reasonable. The standard allows for case-by-case flexibility and can change over time to reflect market practices. The standard is intended to prevent a depository bank from establishing electronic return arrangements that are very limited in scope or that provide unreasonable barriers

to return such that, in practice, the depository bank would accept only a small proportion of its returns electronically.

B. 229.33(b) Acceptance of Electronic Returned Checks and Electronic Notices of Nonpayment

1. A depository bank may agree directly with a returning bank or a paying bank (or through clearinghouse rules) to accept electronic returned checks. Likewise, a depository bank may agree directly with a paying bank (or through clearinghouse rules) to accept electronic written notices of nonpayment. (See §§ 229.2(ggg), 229.30(b), and 229.31(c) and commentary thereto). The depository bank's acceptance of electronic returned checks and electronic written notices of nonpayment is governed by the depository bank's agreement with the banks sending the electronic returned check or electronic written notice of nonpayment to the depository bank (or through the applicable clearinghouse rules). The agreement normally would specify the electronic address or receipt point at which the depository bank accepts returned checks and written notices of nonpayment electronically, as well as what constitutes receipt of the returned checks and written notices of nonpayment. The agreement also may specify whether electronic returned checks must be separated from electronic checks sent for forward collection.

C. 229.33(c) Acceptance of Paper Returned Checks and Paper Notices of Nonpayment

1. This paragraph states where the depository bank is required to accept paper returned checks and paper notices of nonpayment during its banking day. (These locations differ from locations at which a depository bank must accept oral notices or electronic notices. (See § 229.33(b) and (d) and commentary thereto). This paragraph is derived from UCC 3–111, which specifies that presentment for payment may be made at the place specified in the instrument or, if there is none, at the place of business of the party to pay. In the case of returned checks, the depository bank does not print the check and can only specify the place of "payment" of the returned check in its indorsement.

2. The paragraph specifies four locations at which the depository bank must accept paper returned checks and paper notices of nonpayment:

a. The depository bank must accept paper returned checks and paper notices of nonpayment at any location at which it requests presentment of forward collection paper checks, such as a processing center. A depository bank does not request presentment of forward collection checks at a branch of the bank merely by paying checks presented over the counter.

b. i. If the depository bank indorsement states the name and address of the depository bank, it must accept paper returned checks and paper notices of nonpayment at the branch, head office, or other location, such as a processing center, indicated by the address. If the address is too general to identify a particular location, then the depository bank must accept paper returned checks and paper

notices of nonpayment at any branch or head office consistent with the address. If, for example, the address is "New York, New York," each branch in New York City must accept paper returned checks and paper notices of nonpayment. Accordingly, a depository bank may limit the locations at which it must accept paper returned checks and paper notices of nonpayment by specifying a branch or head office in its indorsement.

ii. If no address appears in the depository bank's indorsement, the depository bank must accept paper returned checks and paper notices of nonpayment at any branch or head office associated with the depository bank's routing number. The offices associated with the routing number of a bank are found in *American Bankers Association Key to Routing Numbers*, published by an agent of the American Bankers Association, which lists a city and state address for each routing number.

iii. If no routing number or address appears in its indorsement, the depository bank must accept a paper returned check at any branch or head office of the bank. Section 229.35 and applicable industry standards require that the indorsement contain a routing number, a name, and a location. Consequently paragraphs (c)(1)(ii)(B) and (C) of this section apply only where the depository bank has failed to comply with the indorsement requirement.

3. For ease of processing, a depository bank may require that returning banks or paying banks returning checks to it separate returned checks from forward collection checks being presented.

D. 229.33(d) Acceptance Oral Notices of Nonpayment

In the case of telephone notices, the depository bank may not refuse to accept notices at the telephone numbers identified in this section, but may transfer calls or use a recording device.

E. 229.33(e) Payment

1. As discussed in the commentary to § 229.32(e), under this regulation a paying bank or returning bank does not obtain credit for a returned check by charge-back but by, in effect, "presenting" the returned check to the depository bank. This paragraph imposes an obligation to "pay" a returned check that is similar to the obligation to pay a forward collection check by a paying bank, except that the depository bank may not return a returned check for which it is the depository bank. Also, certain means of payment, such as remittance drafts, may be used only by agreement.

2. The depository bank must pay for a returned check by the close of the banking day on which it received the returned check. The day on which a returned check is received is determined pursuant to UCC 4–108, which permits the bank to establish a cut-off hour, generally not earlier than 2 p.m. (local time of the depository bank), and treat checks received after that hour as being received on the next banking day. If the depository bank is unable to make payment to a returning bank or paying bank on the banking day that it receives the returned

check, because the returning bank or paying bank is closed for a holiday or because the time when the depository bank received the check is after the close of Fedwire, *e.g.*, west coast banks with late cut-off hours, payment may be made on the next banking day of the bank receiving payment.

3. Payment must be made so that the funds are available for use by the bank returning the check to the depository bank on the day the check is received by the depository bank. For example, a depository bank meets this requirement if it sends a wire transfer to the returning bank or paying bank on the day it receives the returned check, even if the returning bank or paying bank has closed for the day. A wire transfer should indicate the purpose of the payment.

4. The depository bank may use a net settlement arrangement to settle for a returned check. Banks with net settlement agreements could net the appropriate credits and debits for returned checks with the accounting entries for forward collection checks if they so desired. If, for purposes of establishing additional controls or for other reasons, the banks involved desired a separate settlement for returned checks, a separate net settlement agreement could be established.

5. The bank sending the returned check to the depository bank may agree to accept payment at a later date if, for example, it does not believe that the amount of the returned check or checks warrants the costs of same-day payment. Thus, a returning bank or paying bank may agree to accept payment through an ACH credit or debit transfer that settles the day after the returned check is received instead of a wire transfer that settles on the same day.

6. This paragraph and this subpart do not affect the depository bank's right to recover a provisional settlement with its nonbank customer for a check that is returned. (See also §§ 229.19(c)(2)(ii), 229.33(h), and 229.35(b)).

F. 229.33(f) Misrouted Returned Checks and Written Notices of Nonpayment

1. This paragraph permits a bank receiving a check or written notice of nonpayment (either in paper form or electronic form) on the basis that it is the depository bank to send the misrouted returned check or written notice of nonpayment to the correct depository bank, if it can identify the correct depository bank, either directly or through a returning bank agreeing to handle the check or written notice of nonpayment. When sending a returned check under this paragraph, the bank receiving the misrouted check is acting as a returning bank. Alternatively, the bank receiving the misrouted returned check or written notice of nonpayment must send the check or notice back to the bank from which it was received.

2. In sending a misrouted returned check, the bank to which the returned check was misrouted (the incorrect depository bank) could receive settlement from the bank to which it sends the misrouted check under § 229.33(f) (the correct depository bank, a returning bank that agrees to handle it, or the bank from which the misrouted check was received). The correct depository bank would

be required to pay for the returned check under § 229.33(e), and any other bank to which the check is sent under this paragraph would be required to settle for the check as a returning bank under § 229.32(e). The bank to which the returned check was misrouted is required to act promptly, *i.e.*, within its midnight deadline. This paragraph does not affect a bank's duties under § 229.35(b).

G. 229.33(g) Charges

1. This paragraph prohibits a depository bank from charging the equivalent of a presentment fee for returned checks. A returning bank, however, may charge a fee for handling returned checks. If the returning bank receives a mixed cash letter of returned checks, which includes some checks for which the returning bank also is the depository bank, the fee may be applied to all the returned checks in the cash letter. In the case of a sorted cash letter containing only returned checks for which the returning bank is the depository bank, however, no fee may be charged.

H. 229.33(h) Notification to Customer

1. This paragraph requires a depository bank to notify its customer of nonpayment upon receipt of a returned check or notice of nonpayment. Notice also must be given if a depository bank receives a notice of recovery under § 229.35(b). A bank that chooses to provide the notice required by § 229.33(h) in writing may send the notice by email or facsimile if the bank sends the notice to the email address or facsimile number specified by the customer for that purpose. The notice to the customer required under this paragraph also may satisfy the notice requirement of § 229.13(g) if the depository bank invokes the reasonable-cause exception of § 229.13(e) due to the receipt of a notice of nonpayment, provided the notice meets all the requirements of § 229.13(g).

XX. Section 229.34 Warranties and Indemnities

A. Introduction

1. Unless otherwise specified, warranties that apply to checks or returned checks also apply to electronic checks and electronic returned checks, including under paragraphs (b) (transfer and presentment warranties with respect to remotely created checks), (c) (settlement amount, encoding, and offset warranties), (d) (returned check warranties), and (e) (notice of nonpayment warranties). (See § 229.30(a) and commentary thereto). Paragraph (f), however, sets forth remote deposit capture indemnities provided to banks that accept an original check for deposit for losses incurred by that depository bank if the loss is due to the check having already been paid. Paragraph (a) sets forth warranties that are given only with respect to electronic checks and electronic returned checks. Paragraph (g) sets forth indemnities with respect to electronically created items.

B. 229.34(a) Warranties With Respect to Electronic Checks and Electronic Returned Checks

1. Paragraph (a) of § 229.34 sets forth the warranties that a bank makes when transferring or presenting an electronic check

or electronic returned check and receiving settlement or other consideration for it. Electronic checks and electronic returned checks sent pursuant to an agreement with the receiving bank are treated as checks subject to subpart C. Therefore, the warranties in § 229.34(a) are in addition to any warranties a bank makes under paragraphs (b), (c), (d), and (e) with respect to an electronic check or electronic returned check. For example, a bank that transfers and receives consideration for an electronic check that is derived from a remotely created check warrants that the remotely created check, from which the electronic check is derived, is authorized by the person on whose account the check is drawn.

2. The warranties in § 229.34(a)(1) relate to a subsequent bank's ability to create a substitute check. This paragraph provides a bank that creates a substitute check from an electronic check or electronic returned check with a warranty claim against any prior bank that transferred the electronic check or electronic returned check. The warranties in this paragraph correspond to the warranties made by a bank that transfers, presents, or returns a substitute check (a paper or electronic representation of a substitute check) for which it receives consideration. (See § 229.52 and commentary thereto). A bank that transfers an electronic check or electronic returned check that is an electronic representation of a substitute check also makes the warranties and indemnities in §§ 229.52 and 229.53.

3. By agreement, a sending and receiving bank may vary the warranties the sending bank makes to the receiving bank for electronic images of or electronic information related to checks, for example, to provide that the bank transferring the check does not warrant that the electronic image or information is sufficient for creating a substitute check. (See § 229.37(a)). The variation by agreement, however, would not affect the rights of banks and persons that are not bound by the agreement.

C. 229.34(b) Transfer and Presentment Warranties With Respect to a Remotely Created Check

1. A bank that transfers or presents a remotely created check and receives a settlement or other consideration warrants that the person on whose account the check is drawn authorized the issuance of the check in the amount stated on the check and to the payee stated on the check. The warranties are given only by banks and only to subsequent banks in the collection chain. The warranties ultimately shift liability for the loss created by an unauthorized remotely created check to the depository bank. The depository bank cannot assert the transfer and presentment warranties against a depositor. However, a depository bank may, by agreement, allocate liability for such an item to the depositor and also may have a claim under other laws against that person. The Federal Trade Commission's Telemarketing Sales Rule (16 CFR part 310) contains further regulatory provisions regarding remotely created checks.

2. The scope of the transfer and presentment warranties for remotely created

checks differs from that of the corresponding UCC warranty provisions in two respects. The UCC warranties are given by any person, including a nonbank depositor, that transfers a remotely created check and not just to a bank, as is the case under § 229.34(b). In addition, the UCC warranties state that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn. The § 229.34(b) warranties specifically cover the amount as well as the payee stated on the check. Neither the UCC warranties, nor the § 229.34(b) warranties, apply to the date stated on the remotely created check.

3. A bank making the § 229.34(b) warranties may defend a claim asserting violation of the warranties by proving that the customer of the paying bank is precluded by UCC 4–406 from making a claim against the paying bank. This may be the case, for example, if the customer failed to discover the unauthorized remotely created check in a timely manner.

4. The transfer and presentment warranties for a remotely created check apply to a remotely created check that has been converted to an electronic check or reconverted to a substitute check.

D. 229.34(c) Settlement Amount, Encoding, and Offset Warranties

1. Paragraph (c)(1) provides that a bank that presents and receives settlement for checks warrants to the paying bank that the settlement it demands (*e.g.*, as noted on the cash letter or in the electronic cash letter file) equals the total amount of the checks it presents. This paragraph gives the paying bank a warranty claim against the presenting bank for the amount of any excess settlement made on the basis of the amount demanded, plus expenses. If the amount demanded is understated, a paying bank discharges its settlement obligation under UCC 4–301 by paying the amount demanded, but remains liable for the amount by which the demand is understated; the presenting bank is nevertheless liable for expenses in resolving the adjustment.

2. When checks or returned checks are transferred to a collecting bank, returning bank, or depository bank, the transferor bank is not required to demand settlement, as is required upon presentment to the paying bank. However, often the checks or returned checks will be accompanied by information (such as a cash letter listing or cash letter control record) that will indicate the total of the checks or returned checks. Paragraph (c)(2) provides that if the transferor bank includes information indicating the total amount of checks or returned checks transferred, it warrants that the information is correct (*i.e.*, equals the actual total of the items).

3. Paragraph (c)(3) provides that a bank that presents or transfers a check or returned check warrants the accuracy of information encoded regarding the check after issue, and that exists at the time of presentment or transfer, to any bank that subsequently handles the check or returned check. Paragraph (c)(3) applies to all MICR-line encoding on a paper check, substitute check, or contained in an electronic check or

electronic returned check. Under UCC 4–209(a), only the encoder (or the encoder and the depository bank, if the encoder is a customer of the depository bank) warrants the encoding accuracy, thus any claims on the warranty must be directed to the encoder. Paragraph (c)(3) expands on the UCC by providing that all banks that transfer or present a check or returned check make the encoding warranty. In addition, under the UCC, the encoder makes the warranty to subsequent collecting banks and the paying bank, while paragraph (c)(3) provides that the warranty is made to banks in the return chain as well.

4. A paying bank that settles for an overstated cash letter because of a misencoded check may make a warranty claim against the presenting bank under paragraph (c)(1) (which would require the paying bank to show that the check was part of the overstated cash letter) or an encoding warranty claim under paragraph (c)(3) against the presenting bank or any preceding bank that handled the misencoded check.

5. Paragraph (c)(4) provides that a paying bank or a depository bank may set off excess settlement paid to another bank against settlement owed to that bank for checks presented or returned checks received (for which it is the depository bank) subsequent to the excess settlement.

E. 229.34(d) Returned Check Warranties

1. This paragraph includes warranties that a returned check, including a notice in lieu of return or an electronic returned check, was returned by the paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, within the deadline under the UCC (subject to any claims or defenses under the UCC, such as breach of a presentment warranty) or § 229.31(g); that the paying bank or returning bank is authorized to return the check; that the returned check has not been materially altered; and that, in the case of a notice in lieu of return, the check has not been and will not be returned for payment. (See commentary to § 229.31(f)). The warranty does not include a warranty that the bank complied with the expeditious return requirements of §§ 229.31(b) and 229.32(b). These warranties do not apply to checks drawn on the United States Treasury, to U.S. Postal Service money orders, or to checks drawn on a state or a unit of general local government that are not payable through or at a bank. (See § 229.42).

F. 229.34(e) Notice of Nonpayment Warranties

1. This paragraph sets forth warranties for notices of nonpayment. This warranty does not include a warranty that the notice is accurate and timely under § 229.31(c). The requirements of § 229.31(c) that are not covered by the warranty are subject to the liability provisions of § 229.38. These warranties are designed to protect depository banks that rely on notices of nonpayment. This paragraph imposes liability on a paying bank that gives notice of nonpayment and then subsequently does not return the check. (See commentary to § 229.31(c)).

G. 229.34(f) Remote Deposit Capture Indemnity

1. This indemnity provides for a depository bank's potential liability when it permits a customer to deposit checks by remote deposit capture (*i.e.*, to truncate checks and deposit an electronic image of the original check instead of the original check). Because the depository bank's customer retains the original check, that customer might, intentionally or mistakenly, deposit the original check in another depository bank. The depository bank that accepts the original check, in turn, may make funds available to the customer before it learns that the check is being returned unpaid and, in some cases, may be unable to recover the funds from its customer. Section 229.34(f) provides the depository bank that accepts the original check for deposit with a claim against the depository bank that did not receive the original check because it permitted its customer to truncate it, received settlement or other consideration for the check, and did not receive a return of the check unpaid. This claim exists only if the check is returned to the depository bank that accepted the original check due to the fact that the check had already been paid.

2. Examples

a. Depository Bank A offers its customers a remote deposit capture service that permits customers to take pictures of the front and back of their checks and send the image to the bank for deposit. Depository Bank A accepts an image of the check from its customer and sends an electronic check for collection to Paying Bank. Paying Bank, in turn, pays the check. Depository Bank A receives settlement for the check. The same customer who sent Depository Bank A the electronic image of the check then deposits the original check in Depository Bank B. There is no restrictive indorsement on the check. Depository Bank B sends the original check (or a substitute check or electronic check) for collection and makes funds from the deposited check available to its customer. The customer withdraws the funds. Paying Bank returns the check to Depository Bank B indicating that the check already had been paid. Depository Bank B may be unable to charge back funds from its customer's account. Depository Bank B may make an indemnity claim against Depository Bank A for the amount of the funds Depository Bank B is unable to recover from its customer.

b. The facts are the same as above with respect to Depository Bank A and B; however, the original check deposited in Depository Bank B bears a restrictive indorsement "for mobile deposit at Depository Bank A only" and the customer's account number at Depository Bank A. Depository Bank B may not make an indemnity claim against Depository Bank A because Depository Bank B accepted the original check bearing a restrictive indorsement inconsistent with the means of deposit.

c. The facts are the same as above with respect to Depository Bank A; however, Depository Bank B also offers a remote deposit capture service to its customer. The customer uses Depository Bank B's remote

deposit capture service to send an electronic image of the front and back of the check, after sending the same image to Depository Bank A. The customer deposits the original check into Depository Bank C without a restrictive indorsement. Paying Bank pays the check based on the image presented by Depository Bank A, and Depository Bank A receives settlement for the check without the check being returned unpaid to it. Paying Bank returns the checks presented by Depository Bank B and Depository Bank C. Neither Depository Bank B nor Depository Bank C can recover the funds from the deposited check from the customer. Depository Bank B does not have an indemnity claim against Depository Bank A because Depository Bank B did not receive the original check for deposit. Depository Bank C, however, would be able to bring an indemnity claim against Depository Bank A.

3. A depository bank may, by agreement, allocate liability for loss incurred from subsequent deposit of the original check to its customer that sent the electronic check related to the original check to the depository bank.

H. 229.34(g) Indemnities With Respect to Electronically-Created Items

1. As a practical matter a bank receiving an electronic image generally cannot distinguish an image that is derived from a paper check from an electronically-created item. Nonetheless, the bank receiving the electronically-created item often handles the electronically-created image as if it were derived from a paper check.

2. Paragraph (g) of § 229.34 sets forth the indemnities that a bank provides when transferring or presenting an electronically-created item and receiving settlement or other consideration for it. The indemnities set forth in § 229.34(g) are provided only by banks and only to subsequent banks in the collection chain. The indemnities ultimately shift liability for losses to the depository bank due to the fact the electronically created item is not derived from a paper check, was unauthorized, or was transferred or presented for payment more than once. (See § 229.34(i) and commentary thereto). The depository bank cannot assert the indemnities set forth in § 229.34(g) against a depositor. However, a depository bank may, by agreement, allocate liability for such an item to the depositor and also may have a claim under other laws against that person.

2. The paying bank's losses in paragraph (g)(1) of this section include losses arising from Regulation E non-compliance caused by the receipt of an electronically-created item.

3. Under paragraphs (g)(2) and (3), indemnified banks have a claim for damages pursuant to § 229.34(i) regardless of whether the damages would have occurred if the item transferred had been derived from a paper check.

3. Examples

a. A paying bank pays an electronically-created item, which the paying bank's customer subsequently claims is unauthorized. The paying bank may incur liability on the item due to the fact the item is electronically created and not derived from a paper check. For example, the paying bank

may have no means of disputing the customer's claim without examining the physical check, which does not exist. The indemnity in § 229.34(g) enables the paying bank to recover from the presenting bank or any prior transferor bank for the amount of its loss, as permitted under § 229.34(i), due to receiving the electronically-created item.

b. A bank receives an electronic image of and electronic information related to an electronically-created item and, in turn, produces a paper item that is indistinguishable from a substitute check. The paper item is not a substitute check because the item is not derived from an original, paper check. That bank may incur a loss because it cannot produce the legal equivalent of a check (See § 229.53 and commentary thereto). The indemnity in § 229.34(g) enables a bank that received the electronically-created item to recover from the bank sending the check for the amount of the loss permitted under § 229.34(i).

c. A paying bank is not required by § 229.31(b) to return an electronically-created item expeditiously. The depository bank incurs a loss because it receives the return of the electronically-created item unexpeditiously and is unable to recover funds previously made available to its customer. The depository bank is not an indemnified party under § 229.34(g) and therefore cannot recover its loss pursuant to that indemnity.

I. 229.34(h) Damages

1. This paragraph adopts for the warranties in § 229.34(a), (b), (c), (d), and (e) the damages provided in UCC 4–207(c) and 4A–506(b). (See definition of interest compensation in § 229.2(oo)).

J. 229.34(i) Indemnity Amounts

1. This paragraph adopts for the amount of the indemnities provided for in § 229.34(f)(2) and (g) an amount comparable to the damages provided in § 229.53(b)(1)(ii) of subpart D of this regulation.

2. The amount of an indemnity would be reduced in proportion to the amount of any loss attributable to the indemnified person's negligence or bad faith. This comparative-negligence standard is intended to allocate liability in the same manner as the comparative negligence provision of § 229.38(c).

3. An indemnified bank may be able to make an indemnity claim against more than one indemnifying depository bank. However, an indemnified bank may not recover in the aggregate across all indemnifying banks more than the amount described in this paragraph. Therefore, an indemnified bank that recovers the amount of its loss from one indemnifying depository bank under this paragraph no longer has a loss that it can collect from a different indemnifying depository bank.

K. 229.34(j) Tender of Defense

1. This paragraph adopts for this regulation the vouching-in provisions of UCC 3–119.

L. 229.34(k) Notice of Claim

1. This paragraph adopts the notice provisions of UCC sections 4–207(d) and 4–208(e) and applies them to this section's

indemnities and warranties. The time limit set forth in this paragraph applies to notices of claims for warranty breaches and for indemnities. As provided in § 229.38(g), all actions under this section must be brought within one year after the date of the occurrence of the violation involved.

XXI. Section 229.35 Indorsements

A. 229.35(a) Indorsement Standards

1. This section requires banks to use a standard form of indorsement when indorsing checks during the forward collection and return process. It is designed to facilitate the identification of the depository bank and the prompt return of checks. The indorsement standard a bank must use depends on the type of check being indorsed. Paper checks must be indorsed in accordance with ANS X9.100–111. Substitute checks must be indorsed in accordance with ANS X9.100–140. Electronic checks must be indorsed in accordance ANS X9.100–187. The Board, however, may by rule or order determine that different standards apply.

2. The parties sending and receiving a check may agree that different indorsement standards will apply to such checks. For example, although ANS X9.100–187 is an industry standard for banks' exchange of electronic checks, the parties may agree to send and receive electronic checks that conform to a different standard.

3. Banks generally apply indorsements to a paper check in one of two ways: (1) In accordance with ANS X9.100–111, banks print or "spray" indorsements onto a paper check when the check is processed through the banks' automated check sorters (regardless of whether the checks are original checks or substitute checks), and (2) in accordance with ANS X9.100–140, reconverting banks print or "overlay" previously applied electronic indorsements and their own indorsements and identifications onto a substitute check at the time that the substitute check is created. If a subsequent substitute check is created in the course of collection or return, that substitute check will contain, in its image of the back of the previous substitute check, reproductions of indorsements that were sprayed or overlaid onto the previous item.

4. A bank might use check-processing equipment that captures an image of a check prior to spraying an indorsement onto that item. If the bank truncates that item, it should ensure that it also applies an indorsement to the item electronically. A reconverting bank satisfies its obligation to preserve all previously applied indorsements by overlaying a bank's indorsement that previously was applied electronically onto a substitute check that the reconverting bank creates. (See commentary to § 229.51(b)).

5. A depository bank may want to include an address in its indorsement in order to limit the number of locations at which it must receive paper returned checks and paper notices of nonpayment. Banks should note, however, that § 229.33(c) requires a depository bank to receive paper returned checks at the location(s) at which it receives paper forward-collection checks, as well as the other locations enumerated in § 229.33(c). (See § 229.33(c) and commentary thereto).

6. Under the UCC, a specific guarantee of prior indorsement is not necessary. (See UCC 4–207(a) and 4–208(a)). Use of guarantee language in indorsements of paper checks, such as “P.E.G.” (“prior endorsements guaranteed”), may result in reducing the type size used in bank indorsements, thereby making them more difficult to read. Use of this language may make it more difficult for other banks to identify the depository bank.

7. If the bank maintaining the account into which a check is deposited agrees with another bank (a correspondent, ATM operator, or lock box operator) to have the other bank accept returns and notices of nonpayment for the bank of account, the indorsement placed on the check as the depository bank indorsement may be the indorsement of the bank that acts as correspondent, ATM operator, or lock box operator as provided in paragraph (d) of § 229.35.

8. In general, paper checks will be handled more efficiently if depository banks place their indorsement so that the nine-digit routing number is not obscured by pre-existing matter on the back of the check. Indorsing parties other than banks, *e.g.*, corporations, will benefit from the faster return of checks if they protect the identifiability and legibility of the depository bank indorsement by staying clear of the area on the back of the paper check reserved for the depository bank indorsement.

9. A paying bank is not required to indorse the check; however, if a paying bank does indorse a check that is returned, it should follow the indorsement standards for collecting banks and returning banks. Collecting banks and returning banks are required to indorse the check for tracing purposes. With respect to the identification of a paying bank that is also a reconverting bank, see commentary to § 229.51(b)(2).

B. 229.35(b) Liability of Bank Handling Check

1. When a check is sent for forward collection, the collection process results in a chain of indorsements extending from the depository bank through any subsequent collecting banks to the paying bank. This paragraph extends the indorsement chain through the paying bank to the returning banks, and would permit each bank to recover from any prior indorser if the claimant bank does not receive payment for the check from a subsequent bank in the collection or return chain. For example, if a returning bank returned a check to an insolvent depository bank, and did not receive the full amount of the check from the failed bank, the returning bank could obtain the unrecovered amount of the check from any bank prior to it in the collection and return chain including the paying bank. Because each bank in the collection and return chain could recover from a prior bank, any loss would fall on the first intermediary collecting bank that received the check from the depository bank. To avoid circuity of actions, the returning bank could recover directly from the first collecting bank. Under the UCC, the first collecting bank might ultimately recover from the depository bank's customer or from the other parties on the check.

2. Where a check is returned through the same banks used for the forward collection of the check, priority during the forward collection process controls over priority in the return process for the purpose of determining prior and subsequent banks under this regulation.

3. Where a returning bank is insolvent and fails to pay the paying bank or a prior returning bank for a returned check, § 229.39(a) requires the receiver of the failed bank to return the check to the bank that transferred the check to the failed bank. That bank then either could continue the return to the depository bank or recover based on this paragraph. Where the paying bank is insolvent, and fails to pay the collecting bank, the collecting bank also could recover from a prior collecting bank under this paragraph, and the bank from which it recovered could in turn recover from its prior collecting bank until the loss settled on the depository bank (which could recover from its customer).

4. A bank is not required to make a claim against an insolvent bank before exercising its right to recovery under this paragraph. Recovery may be made by charge-back or by other means. This right of recovery also is permitted even where nonpayment of the check is the result of the claiming bank's negligence such as failure to make expeditious return, but the claiming bank remains liable for its negligence under § 229.38.

5. This liability to a bank that subsequently handles the check and does not receive payment for the check is imposed on a bank handling a check for collection or return regardless of whether the bank's indorsement appears on the check. Notice must be sent under this paragraph to a prior bank from which recovery is sought reasonably promptly after a bank learns that it did not receive payment from another bank, and learns the identity of the prior bank. Written notice reasonably identifying the check and the basis for recovery is sufficient if the check is not available. Receipt of notice by the bank against which the claim is made is not a precondition to recovery by charge-back or other means; however, a bank may be liable for negligence for failure to provide timely notice. A paying bank or returning bank also may recover from a prior collecting bank as provided in §§ 229.31(a) and 229.32(b) (in those cases where the paying bank is unable to identify the depository bank). This paragraph does not affect a paying bank's accountability for a check under UCC 4–215(a) and 4–302. Nor does this paragraph affect a collecting bank's accountability under UCC 4–214 and 4–215(d). A collecting bank becomes accountable upon receipt of final settlement as provided in the foregoing UCC sections. Final settlement in §§ 229.32(e), 229.33(e), and 229.36(c) is intended to be consistent with final settlement in the UCC (*e.g.*, UCC 4–213, 4–214, and 4–215). (See also § 229.2(cc) (definition of returning bank) and commentary thereto).

6. This paragraph also provides that a bank may have the rights of a holder based on the handling of a check for collection or return. A bank may become a holder or a holder in

due course regardless of whether prior banks have complied with the indorsement standard in § 229.35(a).

7. This paragraph affects the following provisions of the UCC, and may affect other provisions depending on circumstance:

a. Section 4–214(a), in that the right to recovery is not based on provisional settlement, and recovery may be had from any prior bank. Section 4–214(a) would continue to permit a depository bank to recover a provisional settlement from its customer. (See § 229.33(h)).

b. Section 3–415 and related provisions (such as section 3–503), in that such provisions would not apply as between banks, or as between the depository bank and its customer.

C. 229.35(c) Indorsement by Bank

1. This section protects the rights of a customer depositing a check in a bank without requiring the words “pay any bank,” as required by the UCC (See UCC 4–201(b)). Use of this language in a depository bank's indorsement will make it more difficult for other banks to identify the depository bank. The applicable industry standard prohibits such material in subsequent collecting bank indorsements. The existence of a bank indorsement provides notice of the restrictive indorsement without any additional words.

D. 229.35(d) Indorsement for Depository Bank

1. This section permits a depository bank to arrange with another bank to indorse checks. This practice may occur when a correspondent indorses for a respondent, or when the bank servicing an ATM or lock box indorses for the bank maintaining the account in which the check is deposited—*i.e.*, the depository bank. If the indorsing bank applies the depository bank's indorsement, checks will be returned to the depository bank. An indorsing bank may by agreement with the depository bank apply its own indorsement as the depository bank indorsement. In that case, the actual depository bank's own indorsement on the check (if any) should avoid the location reserved for the depository bank. The actual depository bank remains responsible for the availability and other requirements of subpart B, but the bank indorsing as depository bank is considered the depository bank for purposes of subpart C (*e.g.*, for purposes of determining the right to assert a claim under § 229.33(a) for failure to return a check expeditiously and accepting paper checks under § 229.33(c)). The check will be returned, and notice of nonpayment will be given, to the bank indorsing as depository bank.

2. Because the depository bank for subpart B purposes will desire prompt notice of nonpayment, its arrangement with the indorsing bank should provide for prompt notice of nonpayment. The bank indorsing as depository bank may require the depository bank to agree to take up the check if the check is not paid even if the depository bank's indorsement does not appear on the check and it did not handle the check. The arrangement between the banks may constitute an agreement varying the effect of provisions of subpart C under § 229.37.

XXII. Section 229.36 Presentment and Issuance of Checks

A. 229.36(a) Receipt of Electronic Checks

1. A paying bank may agree to accept presentment of electronic checks. (See § 229.2(ggg) and commentary thereto). The paying bank's acceptance of such electronic checks is governed by the paying bank's agreement with the bank sending the electronic check to the paying bank. The terms of these agreements are determined by the parties and may include, for example, the electronic address or electronic receipt point at which the paying bank agrees to accept electronic checks, as well as when presentment occurs. The agreement also may specify whether electronic checks sent for forward collection must be separated from electronic returned checks.

B. 229.36(b) Receipt of Paper Checks

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

a. Delivery of paper checks may be made, and presentment is considered to occur, at a location (including a processing center) requested by the paying bank. This provision adopts the common law rule that the processing center acts as the agent of the paying bank to accept presentment and to begin the time for processing of the check. (See also UCC 4–204(c)). If a bank designates different locations for the presentment of forward collection paper checks bearing different routing numbers, for purposes of this paragraph it requests presentment of paper checks bearing a particular routing number only at the location designated for receipt of forward collection paper checks bearing that routing number.

b. If the check specifies the name and address of a branch or head office, or other location (such as a processing center), the paper check may be delivered to that office or other location. If the address is too general to identify a particular office, delivery may be made at any office consistent with the address. For example, if the address is "San Francisco, California," each office in San Francisco must accept presentment of paper checks. The designation of an address on the check generally is in the control of the paying bank.

c. i. Delivery of a paper check may be made at an office of the bank associated with the routing number on the check. In the case of a substitute check, delivery may be made at an office of the bank associated with the routing number in the electronic check from which it was derived. The office associated with the routing number of a bank is found in *American Bankers Association Key to Routing Numbers*, published by an agent of the American Bankers Association, which lists a city and state address for each routing number. Paper checks generally are handled by collecting banks on the basis of the nine-

digit routing number contained in the MICR line (or on the basis of the fractional form routing number if the MICR line is obliterated) on the check, rather than the printed name or address. The definition of a paying bank in § 229.2(z) includes a bank designated by routing number, whether or not there is a name on the check, and whether or not any name is consistent with the routing number. Where a check is payable by one bank, but payable through another, the routing number is that of the payable-through bank, not that of the payor bank. In these cases, the payor bank has selected the payable-through bank as the point through which presentment of paper checks is to be made.

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

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

d. If the paper check specifies the name of the paying bank but no address, the bank must accept delivery at any office. Where delivery is made by a person other than a bank, or where the routing number is not readable, delivery will be made based on the name and address of the paying bank on the check. If there is no address, delivery may be made at any office of the paying bank. This provision is consistent with UCC 3–111, which states that presentment for payment may be made at the place specified in the instrument, or, if there is none, at the place of business of the party to pay.

2. This paragraph may affect UCC 3–111 to the extent that the UCC requires presentment to occur at a place specified in the instrument.

C. 229.36(c) Liability of Bank During Forward Collection

1. This paragraph makes settlement between banks during forward collection final when made, subject to any deferment of credit, just as settlements between banks during the return of checks are final. In addition, this paragraph clarifies that this change does not affect the liability scheme under UCC 4–201 during forward collection of a check. That UCC section provides that, unless a contrary intent clearly appears, a bank is an agent or subagent of the owner of a check, but that Article 4 of the UCC applies even though a bank may have purchased an item and is the owner of it. This paragraph preserves the liability of a collecting bank to

prior collecting banks and the depository bank's customer for negligence during the forward collection of a check under the UCC, even though this paragraph provides that settlement between banks during forward collection is final rather than provisional. Settlement by a paying bank is not considered to be final payment for the purposes of UCC 4–215(a)(2) or (3), because a paying bank has the right to recover settlement from a returning bank or depository bank to which it returns a check under this subpart. Other provisions of the UCC not superseded by this subpart, such as section 4–202, also continue to apply to the forward collection of a check and may apply to the return of a check. (See definition of returning bank in § 229.2(cc)).

D. 229.36(d) Same-Day Settlement

1. This paragraph governs settlement for presentment of paper checks. Settlement for presentment of electronic checks is governed by the agreement of the parties. (See § 229.36(a) and commentary thereto). This paragraph provides that, under certain conditions, a paying bank must settle with a presenting bank for a paper check on the same day the paper check is presented in order to avail itself of the ability to return the paper check on its next banking day under UCC 4–301 and 4–302. This paragraph does not apply to paper checks presented for immediate payment over the counter. Settling for a paper check under this paragraph does not constitute final payment of the paper check under the UCC. This paragraph does not supersede or limit the rules governing collection and return of paper checks through Federal Reserve Banks that are contained in subpart A of Regulation J (12 CFR part 210).

2. Presentment Requirements

a. Location and Time

i. For presented paper checks to qualify for mandatory same-day settlement, information accompanying the paper checks must indicate that presentment is being made under this paragraph—e.g. "these checks are being presented for same-day settlement"—and must include a demand for payment of the total amount of the checks together with appropriate payment instructions in order to enable the paying bank to discharge its settlement responsibilities under this paragraph. In addition, the paper check or checks must be presented at a location designated by the paying bank for receipt of paper checks for same-day settlement by 8 a.m. local time of that location. The designated presentment location must be a location at which the paying bank would be considered to have received a paper check under § 229.36(b). The paying bank may not designate a location solely for presentment of paper checks subject to settlement under this paragraph; by designating a location for the purposes of § 229.36(d), the paying bank agrees to accept paper checks at that location for the purposes of § 229.36(b).

ii. If the paying bank does not designate a presentment location, it must accept presentment of paper check 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 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 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 paper checks will be accepted for same-day settlement at an alternative location or that the cut-off time for same-day settlement be earlier or later than 8 a.m. local time of the presentment location.

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

b. Reasonable delivery requirements. A paper check is considered presented when it is delivered to and payment is demanded at a location specified in paragraph (d)(1). Ordinarily, a presenting bank will find it necessary to contact the paying bank to determine the appropriate presentment location and any delivery instructions. Further, because presentment might not take place during the paying bank's banking day, a paying bank may establish reasonable delivery requirements to safeguard the paper checks presented, such as use of a night depository. If a presenting bank fails to follow reasonable delivery requirements established by the paying bank, it runs the risk that it will not have presented the paper checks. However, if no reasonable delivery requirements are established or if the paying bank does not make provisions for accepting delivery of checks during its non-business hours, leaving the paper checks at the presentment location constitutes effective presentment.

c. Sorting of checks. A paying bank may require that paper checks presented to it for same-day settlement be sorted separately from other forward collection paper checks it receives as a collecting bank or paper returned checks it receives as a returning bank or depository bank. For example, if a bank provides correspondent check collection services and receives unsorted paper checks from a respondent bank that include paper 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 need not make settlement in accordance with paragraph (d)(3). If the collecting bank receives sorted paper checks from its respondent bank, consisting only of paper checks for which the collecting bank is the paying bank and that meet the requirements for same-day settlement under this paragraph, the collecting bank may not charge a fee for handling those paper checks and must make settlement in accordance with this paragraph.

3. Settlement

a. If a bank presents a paper check in accordance with the time and location requirements for presentment under

paragraph (d)(1), the paying bank either must settle for the paper check on the business day it receives the paper check without charging a presentment fee or return the paper check prior to the time for settlement. (This return deadline is subject to extension under § 229.31(g).) 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), unless the presenting bank agrees with the paying bank to accept settlement in another form (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 paper check is received by the paying bank. Under the provisions of § 229.34(c), a settlement owed to a presenting bank may be set off by adjustments for previous settlements with the presenting bank. (See also § 229.39(d)).

b. Paper checks that are presented after the 8 a.m. (local time of the location at which the paper checks are presented) presentment deadline for same-day settlement and before the paying bank's cut-off hour are treated as if they were presented under other applicable law and settled for or returned accordingly. However, for purposes of settlement only, the presenting bank may require the paying bank to treat such paper checks as presented for same-day settlement on the next business day in lieu of accepting settlement by cash or other means on the business day the paper checks are presented to the paying bank. Paper checks presented after the paying bank's cut-off hour or on non-business days, but otherwise in accordance with this paragraph, are considered presented for same-day settlement on the next business day.

4. Closed Paying Bank

a. There may be certain business days that are not banking days for the paying bank. Some paying banks may continue to settle for paper checks presented on these days (e.g., by opening their back office operations). In other cases, a paying bank may be unable to settle for paper checks presented on a day it is closed. If the paying bank closes on a business day and paper checks are presented to the paying bank in accordance with paragraph (d)(1), the paying bank is accountable for the paper checks unless it settles for or returns the paper checks by the close of Fedwire on its next banking day. In addition, paper checks presented on a business day on which the paying bank is closed are considered received on the paying bank's next banking day for purposes of the UCC midnight deadline (UCC 4-301 and 4-302) and this regulation's expeditious return and notice of nonpayment provisions.

b. If the paying bank is closed on a business day voluntarily, the paying bank must pay interest compensation, as defined in § 229.2(o), to the presenting bank for the value of the float associated with the paper check from the day of the voluntary closing until the day of settlement. Interest compensation is not required in the case of an involuntary closing on a business day, such as a closing required by state law. In addition, if the paying bank is closed on a business day due to emergency conditions,

settlement delays and interest compensation may be excused under § 229.38(e) or UCC 4-109(b).

5. Good faith. Under § 229.38(a), both the presenting bank and paying bank are held to a standard of good faith, defined in § 229.2(nn) to mean honesty in fact and the observance of reasonable commercial standards of fair dealing. For example, designating a presentment location or changing presentment locations for the primary purpose of discouraging banks from presenting paper checks for same-day settlement might not be considered good faith on the part of the paying bank. Similarly, presenting a large volume of paper 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. In addition, if banks, in the general course of business, regularly agree to certain practices related to same-day settlement, it might not be considered consistent with reasonable commercial standards of fair dealing, and therefore might not be considered good faith, for a bank to refuse to agree to those practices if agreeing would not cause it harm.

6. UCC sections affected. This paragraph directly affects the following provisions of the UCC and may affect other sections or provisions:

a. Section 4-204(b)(1), in that a presenting bank may not send a paper check for same-day settlement directly to the paying bank, if the paying bank designates a different location in accordance with paragraph (d)(1).

b. Section 4-213(a), in that the medium of settlement for paper checks presented under this paragraph is limited to a credit to an account at a Federal Reserve Bank and that, for paper checks presented after the deadline for same-day settlement and before the paying bank's cut-off hour, the presenting bank may require settlement on the next business day in accordance with this paragraph rather than accept settlement on the business day of presentment by cash.

c. Section 4-301(a), in that, to preserve the ability to exercise deferred posting, the time limit specified in that section for settlement or return by a paying bank on the banking day a paper check is received is superseded by the requirement to settle for paper checks presented under this paragraph by the close of Fedwire.

d. Section 4-302(a), in that, to avoid accountability, the time limit specified in that section for settlement or return by a paying bank on the banking day a paper check is received is superseded by the requirement to settle for paper checks presented under this paragraph by the close of Fedwire.

XXIII. Section 229.37 Variations by Agreement

A. This section is similar to UCC 4-103, and permits consistent treatment of agreements varying Article 4 or Subpart C, given the substantial interrelationship of the two documents. To achieve consistency, the official comment to UCC 4-103(a) (which in turn follows UCC 1-201(3)) should be followed in construing this section. For example, as stated in Official Comment 2 to

UCC 4–103, owners of items and other interested parties are not affected by agreements under this section unless they are parties to the agreement or are bound by adoption, ratification, estoppel, or the like. In particular, agreements varying this subpart that delay the return of a check beyond the times required by this subpart may result in liability under § 229.38 to entities not party to the agreement.

B. The Board has not followed UCC 4–103(b), which permits Federal Reserve regulations and operating letters, clearinghouse rules, and the like to apply to parties that have not specifically assented. Nevertheless, this section does not affect the status of such agreements under the UCC.

C. The following are examples of situations where variation by agreement is permissible, subject to the limitations of this section:

1. A depository bank may authorize another bank to apply the other bank's indorsement to a check as the depository bank. (See § 229.35(d)).

2. A depository bank may authorize returning banks to commingle paper qualified returned checks with paper forward collection checks. (See § 229.33(c)).

3. A depository bank may limit its liability to its customer in connection with the late return of a deposited check where the lateness is caused by markings on the check by the depository bank's customer or prior indorser in the area of the depository bank indorsement. (See § 229.38(d)).

4. A paying bank may require its customer to assume the paying bank's liability for delayed or missent checks where the delay or missending is caused by markings placed on the check by the paying bank's customer that obscured a properly placed indorsement of the depository bank. (See § 229.38(d)).

5. A collecting bank or paying bank may agree to accept forward collection checks without the indorsement of a prior intermediary collecting bank. (See § 229.35(a)).

6. A bank may agree to accept returned checks without the indorsement of a prior bank. (See § 229.35(a)).

7. A presenting bank may agree with a paying bank to present paper checks for same-day settlement by a deadline earlier or later than 8 a.m. (See § 229.36(d)(1)(ii)).

8. A presenting bank and a paying bank may agree that presentment takes place when the paying bank receives an electronic transmission of information describing the check rather than upon delivery of the physical check. (See § 229.36(b)).

9. A depository bank may agree with a paying bank or returning bank to accept an image or other notice in lieu of a returned check even when the check is available for return under this part. Except to the extent that other parties interested in the check assent to or are bound by the variation of the notice-in-lieu provisions of this part, a depository bank entering into such an agreement may be responsible under this part or other applicable law to other interested parties for any losses caused by the acceptance of an image or notice in lieu of a returned check. (See §§ 229.31(f) and 229.38(a)).

D. The Board expects to review the types of variation by agreement that develop under

this section and will consider whether it is necessary to limit certain variations.

XXIV. Section 229.38 Liability

A. 229.38(a) Standard of Care; Liability; Measure of Damages

1. The standard of care established by this section applies to any bank covered by the requirements of subpart C of the regulation. Thus, the standard of care applies to a paying bank under §§ 229.31, to a returning bank under § 229.32, to a depository bank under §§ 229.33, to a bank erroneously receiving a returned check or written notice of nonpayment as depository bank under § 229.33(f), and to a bank indorsing a check under § 229.35. The standard of care is similar to the standard imposed by UCC 1–203 and 4–103(a) and includes a duty to act in good faith, as defined in § 229.2(nn) of this regulation.

2. A bank not meeting this standard of care is liable to the depository bank, the depository bank's customer, the owner of the check, or another party to the check. The depository bank's customer is usually a depositor of a check in the depository bank (but see § 229.35(d)). The measure of damages provided in this section (loss incurred up to amount of check, less amount of loss party would have incurred even if bank had exercised ordinary care) is based on UCC 4–103(e) (amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care), as limited by 4–202(c) (bank is liable only for its own negligence and not for actions of subsequent banks in chain of collection). This subpart does not absolve a collecting bank of liability to prior collecting banks under UCC 4–201.

3. Under this measure of damages, a depository bank or other person must show that the damage incurred results from the negligence proved. For example, the depository bank may not simply claim that its customer will not accept a charge-back of a returned check, but must prove that it could not charge back when it received the returned check and could have charged back if no negligence had occurred, and must first attempt to collect from its customer. (See *Marcoux v. Van Wyk*, 572 F.2d 651 (8th Cir. 1978); *Appliance Buyers Credit Corp. v. Prospect Nat'l Bank*, 708 F.2d 290 (7th Cir. 1983)). Generally, a paying or returning bank's liability would not be reduced because the depository bank did not place a hold on its customer's deposit before it learned of nonpayment of the check.

4. This paragraph also states that it does not affect a paying bank's liability to its customer. Under UCC 4–402, for example, a paying bank is liable to its customer for wrongful dishonor, which is different from failure to exercise ordinary care and has a different measure of damages.

B. 229.38(b) Paying Bank's Failure To Make Timely Return

1. Section 229.31(b) imposes requirements on the paying bank for expeditious return of a check and leaves in place the UCC deadlines (as they may be modified by § 229.31(g)), which may allow return at a different time. This paragraph clarifies that

the paying bank could be liable for failure to meet either standard, but not for failure to meet both. The regulation intends to preserve the paying bank's accountability for missing its midnight or other deadline under the UCC (e.g., sections 4–215 and 4–302), provisions that are not incorporated in this regulation, but may be useful in establishing the time of final payment by the paying bank.

C. 229.38(c) Comparative Negligence

1. This paragraph establishes a “pure” comparative negligence standard for liability under subpart C of this regulation. This comparative negligence rule may have particular application where a paying bank or returning bank delays in returning a check because of difficulty in identifying the depository bank, where the depository bank has failed to exercise ordinary care in applying its indorsement.

D. 229.38(d) Responsibility for Certain Aspects of Checks

1. ANS X9.100–140 provides that an image of an original check must be reduced in size when placed on the first substitute check associated with that original check. (The image thereafter would be constant in size on any subsequent substitute check that might be created.) Because of this size reduction, the location of an indorsement, particularly a depository bank indorsement, applied to an original paper check likely will change when the first reconverting bank creates a substitute check that contains that indorsement within the image of the original paper check. If the indorsement was applied to the original paper check in accordance with ANS X9.100–111's location requirements for indorsements applied to existing paper checks, and if the size reduction of the image causes the placement of the indorsement to no longer be consistent with ANS X9.100–111's requirements, then the reconverting bank bears the liability for any loss that results from the shift in the placement of the indorsement. Such a loss could result either because the original indorsement applied in accordance with ANS X9.100–111 is rendered illegible by a subsequent indorsement that a reconverting bank later applies to the substitute check in accordance with ANS X9.100–140, or because a subsequent bank receiving a substitute check cannot apply its indorsement to the substitute check legibly in accordance with ANS X9.100–111 as a result of the shift in the previous indorsement.

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

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XXV. Section 229.39 Insolvency of Bank

A. Introduction

1. These provisions cover situations where a bank becomes insolvent during collection or return of a check. Paragraphs (a), (b), and (d) of § 229.39 are derived from UCC 4–216. They are intended to apply to all banks. Like UCC 4–216, paragraphs (a), (b), and (d) of § 229.39 are intended to establish the point

in the collection process at which collection or return of a check should be either stopped or continued when a particular bank suspends payments. Section 229.39(a) sets forth the circumstances under which the receiver must stop collection or return and, instead, send the check back to the bank or customer that transferred the check. Section 229.39(b) sets forth the circumstances under which the collection or return of the check should continue. Paragraphs (a) and (b) of § 229.39 are not intended to confer upon banks preferential positions in the event of bank failures over general depositors or any other creditor of the failed bank. (See UCC 4–216, cmt. 1).

B. 229.39(a) Duty of Receiver To Return Unpaid Checks

1. This paragraph requires a receiver of a closed bank to return a check to the prior bank if the paying bank or the receiver did not pay for the check. This permits the prior bank, as holder, to pursue its claims against the closed bank or prior indorsers on the check.

C. 229.39(b) Claims Against Banks for Checks Not Returned by the Receiver

1. This section sets forth the claims available to banks in situations in which a receiver does not return a check under § 229.39(a). In those situations, the prior bank would not be a holder of the check and would be unable to pursue claims as a holder.

2. Paragraph (b)(1) of § 229.39 gives a bank a claim against a closed paying bank that finally pays a check without settling for it or a closed depository bank that becomes obligated to pay a returned check without settling for it. If the bank with a claim under this paragraph recovers from a prior bank or other party to the check, the prior bank or other party to the check is subrogated to the claim.

3. Paragraph (b)(2) of § 229.39 gives a bank a claim against a closed collecting bank, paying bank, or returning bank that receives settlement for but does not make settlement for a check. (See commentary to § 229.35(b) for discussion of prior and subsequent banks). As in the case of § 229.39(b)(1), if the bank with a claim under this paragraph recovers from a prior bank or other party to the check, the prior bank or other party to the check is subrogated to the claim.

D. 229.39(c) Preferred Claim Against Presenting Bank for Breach of Warranty

1. This paragraph gives a paying bank a preferred claim against a closed presenting bank in the event that the presenting bank breaches an amount or encoding warranty as provided in § 229.34(c)(1) or (3) and 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. This preferred claim is intended to have the effect of a perfected security interest and is intended to put the paying bank in the position of a secured creditor for purposes of the receivership provisions of the Federal Deposit Insurance Act and similar provisions of state law.

E. 229.39(d) Finality of Settlement

1. This paragraph provides that insolvency does not interfere with the finality of a settlement, such as a settlement by a paying bank that becomes final by expiration of the midnight deadline.

XXVI. Section 229.40 Effect on Merger Transaction

A. When banks merge, there is normally a period of adjustment before their operations are consolidated. To allow for this adjustment period, the regulation provides that the merged banks may be treated as separate banks for a period of up to one year after the consummation of the transaction. The term merger transaction is defined in § 229.2(t). This rule affects the status of the combined entity in a number of areas in this subpart, such as the following:

1. The paying bank's responsibility for notice of nonpayment (§ 229.31(c)).
2. Where the depository bank must accept returned checks (§ 229.33(b) and (c)).
3. Where the depository bank must accept notice of nonpayment (§ 229.33(b) and (c)).
4. Where a paying bank must accept presentment of paper checks (§ 229.36(b)).

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XXIX. Section 229.43 Checks Payable in Guam, American Samoa, and the Northern Mariana Islands

A. 229.43(a) Definitions

1. For purposes of subparts B and C of this part, bank offices in Guam, American Samoa, and the Northern Mariana Islands (which Regulation CC defines as Pacific island banks) do not meet the definition of bank in § 229.2(e) because they are not located in the United States. Some checks drawn on Pacific island banks (defined as Pacific island checks) bear U.S. routing numbers and are collected and returned by banks in the same manner as checks payable in the U.S.

B. 229.43(b) Rules Applicable to Pacific Island Checks

1. When a bank handles a Pacific island check as if it were a check as defined in § 229.2(k), or an electronic image and electronic information derived from a demand draft as defined in § 229.43(a)(2), the bank is subject to certain provisions of subpart C of this part, as provided in this section. Because a Pacific island bank is not a bank as defined in § 229.2(e) for purposes of subpart C, it is not a paying bank as defined in § 229.2(z) for purposes of subpart C (unless otherwise noted in this section). Pacific island banks are not subject to the provisions of subparts B and C, but may be subject to the provisions of subpart D of this part to the extent they create substitute checks. (See § 229.2(f) defining "State").

2. A bank may agree to handle a Pacific island check as a returned check under § 229.32 and may convert the returned Pacific island check to a qualified returned check. The returning bank may receive the Pacific island check directly from a Pacific island bank or from another returning bank. As a Pacific island bank is not a paying bank for purposes of subpart C of this part, § 229.32(e) does not apply to a returning bank settling with the Pacific island bank.

3. A depository bank that handles a Pacific island check is not subject to the provisions of subpart B of Regulation CC, including the availability, notice, and interest accrual requirements, with respect to that check. If, however, a bank accepts a Pacific island check for deposit (or otherwise accepts the check as transferee) and collects the Pacific island check in the same manner as other checks, the bank generally is subject to the provisions of § 229.33, except for § 229.33(c) with respect to its application to paper notices of nonpayment, § 229.33(d) (acceptance of oral notices of nonpayment), and § 229.33(h) (notification to customer of returned check). If the depository bank receives the returned Pacific island check directly from the Pacific island bank, the provisions of § 229.33(e) (regarding time and manner of settlement for returned checks) do not apply, because the Pacific island bank is not a paying bank for purposes of subpart C of this part. In the event the Pacific island check is returned by a returning bank, however, the provisions of § 229.33(e) apply. The depository bank is not subject to the provisions in § 229.33(c) with respect to paper notices of nonpayment for Pacific island checks, but is subject to § 229.33(c) with respect to paper returned checks that are Pacific island checks.

4. Banks that handle Pacific island checks in the same manner as other checks are subject to the indorsement provisions of § 229.35. Section 229.35(c) eliminates the need for the restrictive indorsement "pay any bank." For purposes of § 229.35(c), the Pacific island bank is deemed to be a bank.

5. Pacific island checks will often be intermingled with other checks in a single cash letter. Therefore, a bank that handles Pacific island checks in the same manner as other checks is subject to the transfer warranty provision in § 229.34(c)(2) regarding accurate cash letter totals and the encoding warranty in § 229.34(c)(3). A bank that acts as a returning bank for a Pacific island check is not subject to the returned check warranties in § 229.34(d). Similarly, because the Pacific island bank is not a "bank" or a "paying bank" for purposes of subpart C of this part, the notice of nonpayment warranties in § 229.34(e), and the presentment warranties in § 229.34(c)(1) and (c)(4) do not apply. For the same reason, the provisions of § 229.36 governing paying bank responsibilities such as place of receipt and same-day settlement do not apply to checks presented to a Pacific island bank, and the liability provisions applicable to paying banks in § 229.38 do not apply to Pacific island banks. Section 229.36(c), regarding finality of settlement between banks during forward collection, applies to banks that handle Pacific island checks in the same manner as other checks, as do the liability provisions of § 229.38, to the extent the banks are subject to the requirements of Regulation CC as provided in this section, and §§ 229.37 and 229.39 through 229.42.

XXX. Section 229.51 General Provisions Governing Substitute Checks

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B. 229.51(b) Reverting Bank Duties

1. In accordance with ANS X9.100–140, a reverting bank must indorse (or, if it is a paying bank with respect to the check or a bank that rejected a check submitted for deposit, identify itself on) the back of a substitute check in a manner that preserves all indorsements applied, whether physically or electronically, by persons that previously handled the check in any form for forward collection or return. Indorsements applied physically to the original check before an image of the check was captured would be preserved through the image of the back of the original check that a substitute check must contain. If a bank sprays an indorsement onto a paper check *after* it captures an image of the check, it should ensure that it applies an indorsement to the item electronically, if it transfers the check as an electronic check or electronic returned check. (See paragraph 4 of commentary to section 229.35(a)). A reverting bank satisfies its obligation to preserve all previously applied indorsements by physically applying (overlying) electronic indorsements onto a substitute check that the reverting bank creates. A reverting bank is not responsible for obtaining indorsements that persons that previously handled the check in any form should have applied but did not apply.

2. A reverting bank must identify itself and the truncating bank by applying its routing number and the routing number of the truncating bank to the front of a substitute check in accordance with ANS X9.100–140.

3. If the reverting bank is the paying bank or a bank that rejected a check submitted for deposit, it also must identify itself by applying its routing number to the back of the check. A reverting bank also must preserve on the back of the substitute check, in accordance with ANS X9.100–140, the identifications of any previous reverting banks. The reverting-bank and truncating-bank routing numbers on the front of a substitute check and, if the reverting bank is the paying bank or a bank that rejected a check submitted for deposit, the reverting bank's routing number on the back of a substitute check are for identification only and are not indorsements or acceptances.

Example. A bank's customer, which is a nonbank business, receives checks for payment and by agreement deposits substitute checks instead of the original checks with its depository bank. The depository bank is the reverting bank with respect to the substitute checks and the truncating bank with respect to the original checks. In accordance with ANS X9.100–140, the bank must therefore be identified on the front of the substitute checks as a reverting bank and as the truncating bank, and on the back of the substitute checks as the depository bank and a reverting bank.

4. The location of an indorsement applied to a paper check in accordance with ANS X9.100–111 may shift if that check is truncated and later reconverted to a substitute check. If an indorsement applied to an original check in accordance with ANS X9.100–111 is overwritten by a subsequent

indorsement applied to a substitute check in accordance with industry standards, then one or both of those indorsements could be rendered illegible. As explained in § 229.38(c) and the commentary thereto, a reverting bank is liable for losses associated with indorsements that are rendered illegible as a result of check substitution.

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XXXI. Section 229.52 Substitute Check Warranties*A. 229.52(a) Warranty Content and Provision*

1. The responsibility for providing the substitute-check warranties begins with the reverting bank. In the case of a substitute check created by a bank, the reverting bank starts the flow of warranties when it transfers, presents, or returns a substitute check for which it receives consideration or when it rejects a check submitted for deposit and returns to its customer a substitute check. A bank that receives a substitute check created by a nonbank starts the flow of warranties when it transfers, presents, or returns for consideration either the substitute check it received or an electronic or paper representation of that substitute check.

2. To ensure that warranty protections flow all the way through to the ultimate recipient of a substitute check or paper or electronic representation thereof, any subsequent bank that transfers, presents, or returns for consideration either the substitute check or a paper or electronic representation of the substitute check is responsible to subsequent transferees for the warranties. Any warranty recipient could bring a claim for a breach of a substitute-check warranty if it received either the actual substitute check or a paper or electronic representation of a substitute check.

3. The substitute-check warranties and indemnity are not given under sections 229.52 and 229.53 by a bank that truncates the original check and by agreement transfers an electronic check to a subsequent bank for consideration. However, the warranties in § 229.34(a) would apply to the transfer of an electronic check, and those warranties may be varied by agreement between the parties. A bank that is a truncating bank under § 229.2(eee)(2) because it accepts a deposit of a check electronically might be subject to a claim by another depository bank that accepts the original check for deposit. (See § 229.34(f) and commentary thereto).

Example. A bank that receives an electronic check and uses it to create substitute checks is the reverting bank and, when it transfers, presents, or returns that substitute check, becomes the first warrantor with respect to the substitute check warranties. That bank, however, may have similar warranty claims with respect to the electronic check under § 229.34(a) against the bank that transferred the electronic check.

4. A bank need not affirmatively make the warranties because they attach automatically when a bank transfers, presents, or returns the substitute check (or a representation thereof) for which it receives consideration. Because a substitute check transferred,

presented, or returned for consideration is warranted to be the legal equivalent of the original check and thereby subject to existing laws as if it were the original check, all UCC and other Regulation CC warranties that apply to the original check also apply to the substitute check.

5. The legal-equivalence warranty by definition must be linked to a particular substitute check. When an original check is truncated, the check may move from electronic form to substitute-check form and then back again, such that there would be multiple substitute checks associated with one original check. When a check changes form multiple times in the collection or return process, the first reverting bank and subsequent banks that transfer, present, or return the first substitute check (or a paper or electronic representation of the first substitute check) warrant the legal equivalence of only the first substitute check. If a bank receives an electronic representation of a substitute check and uses that representation to create a second substitute check, the second reverting bank and subsequent transferees of the second substitute check (or a representation thereof) warrant the legal equivalence of both the first and second substitute checks. A reverting bank would not be liable for a warranty breach under section 229.52 if the legal-equivalence defect is the fault of a subsequent bank that handled the substitute check, either as a substitute check or in other paper or electronic form.

6. The warranty in § 229.52(a)(1)(ii), which addresses multiple payment requests for the same check, is not linked to a particular substitute check but rather is given by each bank handling the substitute check, an electronic representation of a substitute check, or a subsequent substitute check created from an electronic representation of a substitute check. All banks that transfer, present, or return a substitute check (or a paper or electronic representation thereof) therefore provide the warranty regardless of whether the ultimate demand for double payment is based on the original check, the substitute check, or some other electronic or paper representation of the substitute or original check, and regardless of the order in which the duplicative payment requests occur. This warranty is given by the banks that transfer, present, or return a substitute check even if the demand for duplicative payment results from a fraudulent substitute check about which the warranting bank had no knowledge. (See also § 229.34(a)(1)(ii)).

Example. A nonbank depositor truncates a check and in lieu of the check sends an electronic check to both Bank A and Bank B. Bank A and Bank B each use the check information that it received electronically to create a substitute check, which it presents to Bank C for payment. Bank A and Bank B are both reverting banks and each made the substitute-check warranties when it presented a substitute check to and received payment from Bank C. Bank C could pursue a warranty claim for the loss it suffered as a result of the duplicative payment against either Bank A or Bank B.

7. A bank that rejects a check submitted for deposit and, instead of the original check,

provides its customer with a substitute check makes the warranties in § 229.52(a)(1). As noted in the commentary to § 229.2(ccc), the Check 21 Act contemplates that nonbank persons that receive substitute checks (or representations thereof) from a bank will receive warranties and indemnities with respect to the checks. A reconverting bank that provides a substitute check to its depositor after it has rejected the check submitted for deposit may not have received consideration for the substitute check. In order to prevent banks from being able to transfer a check the bank truncated and then reconverted without providing substitute check warranties, the regulation provides that a bank that rejects a check submitted for deposit but provides its customer with a substitute check (or a paper or electronic representation of a substitute check) makes the warranties set forth in § 229.52(a)(1) regardless of whether the bank received consideration.

Example. A bank's customer submits a check for deposit at an ATM that captures an image of the check and sends the image electronically to the bank. After reviewing the item, the bank rejects the item submitted for deposit. Instead of providing the original check to its customer, the bank provides a substitute check to its customer. This bank is the reconverting bank with respect to the substitute check and makes the warranties described in § 229.52(a)(1) regardless of whether the bank previously extended credit to its customer. (See commentary to § 229.2(ccc)).

B. 229.52(b) Warranty Recipients

1. A reconverting bank makes the warranties to the person to which it transfers, presents, or returns the substitute check for consideration and to any subsequent recipient that receives either the substitute check or a paper or electronic representation derived from the substitute check. These subsequent recipients could include a subsequent collecting or returning bank, the depository bank, the drawer, the drawee, the payee, the depositor, and any indorser. The paying bank would be included as a warranty recipient, for example because it would be the drawee of a check or a transferee of a check that is payable through it.

2. The warranties flow with the substitute check to persons that receive a substitute check or a paper or electronic representation of a substitute check. The warranties do not flow to a person that receives only the original check or a representation of an original check that was not derived from a substitute check. However, a person that initially handled only the original check could become a warranty recipient if that person later receives a returned substitute check or a paper or electronic representation of a substitute check that was derived from that original check. (See § 229.34(f) regarding claims by a depository bank that accepts deposit of an original check).

3. A reconverting bank also makes the warranties to a person to whom the bank transfers a substitute check that the bank has rejected for deposit regardless of whether the bank received consideration.

XXXII. Section 229.53 Substitute Check Indemnity

A. 229.53(a) Scope of Indemnity

1. Each bank that for consideration transfers, presents, or returns a substitute check or a paper or electronic representation of a substitute check is responsible for providing the substitute-check indemnity.

2. The indemnity covers losses due to any subsequent recipient's receipt of the substitute check instead of the original check. The indemnity therefore covers the loss caused by receipt of the substitute check as well as the loss that a bank incurs because it pays an indemnity to another person. A bank that pays an indemnity would in turn have an indemnity claim regardless of whether it received the substitute check or a paper or electronic representation of the substitute check. The indemnity would not apply to a person that handled only the original check or a paper or electronic image of the original check that was not derived from a substitute check.

3. A reconverting bank also provides the substitute check indemnity to a person to whom the bank transfers a substitute check (or a paper or electronic representation of a substitute check) derived from a check that the bank has rejected for deposit regardless of whether the bank providing the indemnity has received consideration.

* * * * *

B. 229.53(b) Indemnity Amount

1. If a recipient of a substitute check is making an indemnity claim because a bank has breached one of the substitute-check warranties, the recipient can recover any losses proximately caused by that warranty breach.

Examples

a. A drawer discovers that its account has been charged for two different substitute checks that were provided to the drawer and that were associated with the same original check. As a result of this duplicative charge, the paying bank dishonored several subsequently presented checks that it otherwise would have paid and charged the drawer returned-check fees. The payees of the returned checks also charged the drawer returned-check fees. The drawer would have a warranty claim against any of the warranting banks, including its bank, for breach of the warranty described in § 229.52(a)(1)(ii). The drawer also could assert an indemnity claim. Because there is only one original check for any payment transaction, if the collecting bank and presenting bank had collected the original check instead of using a substitute check the

bank would have been asked to make only one payment. The drawer could assert its warranty and indemnity claims against the paying bank, because that is the bank with which the drawer has a customer relationship and the drawer has received an indemnity from that bank. The drawer could recover from the indemnifying bank the amount of the erroneous charge, as well as the amount of the returned-check fees charged by both the paying bank and the payees of the returned checks. If the drawer's account were an interest-bearing account, the drawer also could recover any interest lost on the erroneously debited amount and the erroneous returned-check fees. The drawer also could recover its expenditures for representation in connection with the claim. Finally, the drawer could recover any other losses that were proximately caused by the warranty breach.

b. In the example above, the paying bank that received the duplicate substitute checks also would have a warranty claim against the previous transferor(s) of those substitute checks and could seek an indemnity from that bank (or either of those banks). The indemnifying bank would be responsible for compensating the paying bank for all the losses proximately caused by the warranty breach, including representation expenses and other costs incurred by the paying bank in settling the drawer's claim.

* * * * *

3. The amount of an indemnity would be reduced in proportion to the amount of any loss attributable to the indemnified person's negligence or bad faith. This comparative-negligence standard is intended to allocate liability in the same manner as the comparative-negligence provision of section 229.38(c).

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XXXIII. 229.54 Expedited Recredit for Consumers

A. * * *

2. A consumer must in good faith assert that the bank improperly charged the consumer's account for the substitute check or that the consumer has a warranty claim for the substitute check (or both). The warranty in question could be a substitute-check warranty described in section 229.52 or any other warranty that a bank provides with respect to a check under other law. A consumer could, for example, have a warranty claim under section 229.34(a) or (d), which contain returned-check warranties that are made to the owner of the check.

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By order of the Board of Governors of the Federal Reserve System, May 26, 2017.

Ann E. Misback,
Secretary of the Board.

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