

FEDERAL RESERVE SYSTEM

12 CFR Part 210

[Regulation J; Docket No. R-1202]

Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board of Governors is publishing for comment a proposed rule that would amend subpart A of Regulation J to provide for the rights and obligations of sending banks, paying banks, returning banks, and Reserve Banks in connection with collection of substitute checks and items that have been converted to electronic form. The proposed changes would ensure that Regulation J covers the new check processing service options that the Reserve Banks plan to offer when the Check Clearing for the 21st Century Act becomes effective on October 28, 2004.

DATES: Comments on the proposed rule must be received on or before July 26, 2004.

ADDRESSES: You may submit comments, identified by Docket No. R-1202, by any of the following methods:

- Agency Web Site: <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- FAX: 202/452-3819 or 202/452-3102.
- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551.

All public comments are available from the Board's web site at www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, except as necessary for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

FOR FURTHER INFORMATION CONTACT: Jack K. Walton, II, Assistant Director (202/452-2660), or Joseph P. Baressi, Senior Financial Services Analyst (202/452-3959),

Division of Reserve Bank Operations and Payment Systems; or Adrienne G. Threatt, Counsel (202/452-3554), Legal Division; for users of Telecommunication Devices for the Deaf (TDD) only, contact 202/263-4869.

SUPPLEMENTARY INFORMATION:

Background

Subpart A of Regulation J governs collection of checks and other items by the Reserve Banks. This subpart includes the warranties and indemnities that are given to the Reserve Banks by parties that send items to the Reserve Banks for collection and return, as well as the warranties and indemnities for which the Reserve Banks are responsible in connection with the items they handle. Subpart A of Regulation J also describes the Reserve Banks' security interest in the assets of banks for which they collect items, as well as the amounts and methods by which the Reserve Banks may recover for losses associated with their collection of items. Subpart A authorizes the Reserve Banks to issue operating circulars governing the details of the collection of checks and other items and provides that such operating circulars have binding effect on all parties interested in an item handled by a Reserve Bank. The Reserve Banks' Operating Circular No. 3, "Collection of Cash Items and Returned Checks" (OC 3), is the operating circular that is most relevant to the Reserve Banks' check collection activities.

Under existing Regulation J, the term "item" is understood to mean a paper instrument. Although Reserve Banks in some cases accept, transfer, present, or return items in electronic form, the rights and obligations associated with handling items electronically currently are specified in OC 3 and the appendices thereto, rather than in Regulation J.

Once the Check Clearing for the 21st Century Act (the Check 21 Act) takes effect on October 28, 2004, the Board expects that the Reserve Banks will offer a wider variety of services that involve handling items electronically. In addition, the Board expects that the Reserve Banks in some cases will act as "reconverting banks" that create substitute checks and provide the associated substitute check warranties and indemnity in accordance with the Check 21 Act and subpart D of the Board's Regulation CC.¹

The proposed amendments to Regulation J primarily are designed (1) to cover the Reserve Banks' handling of electronic items explicitly under Regulation J, (2) to acknowledge the substitute check warranties and indemnity that Reserve Banks and other banks will make under the Check 21 Act and subpart D when handling a substitute check or a paper or electronic representation of a substitute check, and (3) to include new

¹ The Board has proposed to implement the Check 21 Act by adding a new subpart D to existing Regulation CC (69 FR 1470, Jan. 8, 2004). The comment period for this proposed rule expired on March 12, 2004, and the Board intends to finalize subpart D no later than July of this year.

warranties and indemnities that will apply when Reserve Banks and other banks send an electronic item that is not otherwise covered by the Check 21 Act and subpart D.²

Section-by-Section Analysis

Section 210.1 Authority, purpose, and scope.

The Board proposes to amend this section to acknowledge the Check 21 Act as a source of authority.

Section 210.2 Definitions.

A. Check. The Board proposes to amend the definition of check by adding a cross-reference to new subpart D of Regulation CC.

B. Item. To bring electronic items under the coverage of Regulation J, the Board proposes to amend the definition of item to include an electronic image of a paper item, together with information describing that item, that a Reserve Bank handles pursuant to an operating circular. This type of item would be defined as an electronic item.

C. Paying bank. Regulation J currently defines a bank whose routing number appears on the check “in magnetic characters or fractional form” as a paying bank. The electronic items that would be covered by the proposed expansion of the definition of item would contain MICR-line information but would not contain characters encoded in magnetic ink. The Board therefore proposes to replace the reference to “magnetic characters” with a reference to the information in the item’s magnetic ink character recognition (MICR) line or in fractional form on the front of the check, or in the MICR-line information that accompanies an electronic item.

D. Sender. To further clarify the entities that are senders, the Board proposes to add Federal Reserve Banks and U.S. branches and agencies of foreign banks as entities listed in that definition. The Board also proposes technical amendments to streamline the definition.

E. Undefined terms. The Board proposes to reformat existing language explaining that terms that are not directly defined in § 210.2 of Regulation J have the meanings set forth in Regulation CC or the UCC and to add a cross-reference to new subpart D of Regulation CC. This reformatted language would be in a new paragraph (s).

Section 210.3 General provisions.

The Board proposes to amend paragraph (b) of this section to state explicitly that new subpart D of Regulation CC would be binding on all parties interested in an item

² The Board expects that the Reserve Banks will amend OC 3 to address the operational details associated with new check processing services following the Board’s adoption of final amendments to Regulation CC and Regulation J.

handled by a Reserve Bank. Although subpart D would apply even in the absence of this reference, the Board believes that an explicit statement in Regulation J promotes clarity.

Section 210.4 Sending items to Reserve Banks.

Section 210.4(b) lists the parties that are deemed to have handled an item that is sent to a Reserve Bank in the order in which they are deemed to have handled it. The Board proposes to add at the end of that list the Administrative Reserve Bank of the bank to which a Reserve Bank sends or presents the item. This addition clarifies the chain of parties deemed to have handled an item.

Section 210.5 Sender's Agreement; Recovery by Reserve Bank.

In paragraph (a), the Board proposes adding to the list of warranties made to each Reserve Bank a new warranty that the item bears all indorsements applied by previous parties that handled the item for forward collection or return. This amendment would facilitate compliance with the requirement under the Check 21 Act that a reconverting bank preserve all previously-applied indorsements. This new warranty does not require senders to obtain missing indorsements, but rather parallels the Check 21 Act's requirement that a reconverting bank preserve the indorsements applied by all parties that previously handled a check in any form. The proposed new warranty would be of particular relevance for items that have been indorsed in electronic form, because a Reserve Bank (or other collecting bank) that handles such an item might convert it to a substitute check and thus have a duty under the Check 21 Act to preserve all previously-applied indorsements.

The Board also proposes that paragraph (a) explicitly acknowledge the warranties and indemnities that a sending bank makes under Regulation CC subject to the terms of that regulation. Proposed paragraph (a)(3)(i) would list the settlement, encoding, and offset warranties in § 229.34(c)(2)-(4) of Regulation CC. Proposed paragraph (a)(3)(ii) would acknowledge explicitly that a sender makes the warranties and indemnity specified in subpart D of Regulation CC (which implements the Check 21 Act) when sending an item in the form of a substitute check or a paper or electronic representation of a substitute check. Although senders would make each of these warranties as provided in Regulation CC even if the warranties were not listed in paragraph (a), the Board believes that the meaning of the rule is clearer if paragraph (a) specifically acknowledges these warranties. These changes also conform the list of senders' warranties in § 210.5(a) of Regulation J to the list of the Reserve Banks' warranties in § 210.6(b) of the regulation.

Proposed paragraph (a) would supplement the warranties that are given under other law by including new warranties that a sender would give only under Regulation J to each Reserve Bank that handles an electronic item that is not a representation of a substitute check and thus is not subject to the Check 21 Act warranties. The Reserve Banks anticipate that most electronic items they will receive will fall into this category and that the Reserve Banks or subsequent parties might later use such electronic items to create substitute checks. A recipient of an electronic item that is not subject to the Check

21 Act (i.e., an electronic item created directly from an original check) would not receive the Check 21 Act warranties from the sending bank. However, that recipient would itself make the Check 21 Act warranties if it subsequently used the electronic item to create a substitute check that it transferred for value. The proposed new warranties in Regulation J thus are designed to allow the recipient of an electronic item to pass back liabilities incurred under the Check 21 Act but for which the recipient did not receive corresponding Check 21 Act protections. The proposed new electronic item warranties therefore closely track the substitute check warranties contained in the Check 21 Act.

The amendments described in the analysis of § 210.6(b) would explicitly acknowledge the Reserve Banks' responsibility for the new Check 21 Act indemnity to be implemented in § 229.53 of Regulation CC and would add a new indemnity that Reserve Banks would give for electronic items that are not subject § 229.53. The Board therefore proposes to add two new paragraphs to newly-redesignated § 210.5(a)(5) that would allow the Reserve Bank in certain circumstances to pass back to the sender losses the Reserve Bank incurs in connection with these indemnities. Specifically, new § 210.5(a)(5)(iv) would require a sender who sent a substitute check (or a paper or electronic representation of a substitute check) to indemnify the Reserve Bank for losses that the Reserve Bank incurred as a result of an indemnity that it made under §§ 210.6(b)(2) and 229.53. Similarly, new § 210.5(a)(5)(v) would require a sender who sent an electronic item to indemnify the Reserve Bank for losses that the Reserve Bank incurred because it made an indemnity for that electronic item under § 210.6(b)(3). The Board also proposes that newly-redesignated § 210.5(c)(3) (currently § 210.5(b)(3)) specify that the Reserve Banks' recovery rights under newly-redesignated § 210.5(c) extend to any indemnity that the Reserve Banks provide under § 210.6(b).

An undesignated phrase after existing paragraph (a)(2) currently specifies that the warranties listed in paragraph (a) do not limit warranties that a sender gives under other law. The Board proposes to move this text to a new paragraph (b) and to amend the text to cover both warranties and indemnities provided under other law. The remaining paragraphs of § 210.5 would be redesignated, and where necessary cross-references would be amended, to reflect the inclusion of new paragraph (b).

Section 210.6 Status, Warranties, and Liability of Reserve Bank

The Board proposes to amend § 210.6 regarding the warranty and other liabilities of Reserve Banks for items that they handle.

The Board proposes to amend paragraph (a) to acknowledge explicitly the Reserve Banks' status and liability when handling substitute checks under the Check 21 Act and subpart D of Regulation CC. The Board also proposes to redesignate existing text from paragraph (b)(2) regarding the limitations on a Reserve Bank's liability as a new paragraph (c) and to redesignate existing paragraph (c) as paragraph (d). Redesignated paragraph (d) would be amended to include a one-year statute of limitations for claims relating to the new supplemental warranty in paragraph (b)(4) (which specifies warranties made when handling electronic items that are not subject to the Check 21 Act

or Regulation CC) and to specify that paragraph (d) does not extend the time for bringing claims under subpart D of Regulation CC.

The Board proposes to amend paragraph (b) along the same lines as § 210.5(a) so that the protections that the Reserve Banks give when they handle an item for forward collection parallel the protections that the Reserve Banks receive from senders. Specifically, the Board proposes to add a new paragraph (b)(1)(iii), to provide that Reserve Banks handling an item for forward collection would make the same warranty regarding preservation of previously-applied indorsements that a sender would give under proposed § 210.5(a)(2)(iii). Similarly, paragraph (b)(2) would parallel § 210.5(a)(3) by explicitly acknowledging the Reserve Banks' responsibilities under subparts C and D of Regulation CC, including the warranties and indemnity that Reserve Banks would give when handling a substitute check or a paper or electronic representation of a substitute check. Paragraph (b)(3) would parallel the new warranties in § 210.5(a)(4) that flow with the transfer of an electronic item that is not subject to the Regulation CC warranties. Paragraph (b)(3) also would add a new indemnity that Reserve Banks would make if an electronic item they sent later were converted to a substitute check that was subject to an indemnity claim under § 229.53 of Regulation CC.

Section 210.12 Return of cash items and handling of returned checks.

The Board proposes to amend paragraph (b) to parallel the proposed amendments to § 210.4 by including the Administrative Reserve Bank of the bank to which a Reserve Bank returns a check in the chain of parties deemed to have handled a check. Proposed amendments to paragraphs (c) and (d) parallel the proposed amendments to §§ 210.5 and 210.6 by making the return warranties and indemnities given by paying and returning banks and Reserve Banks correspond to the forward-side warranties given by senders and Reserve Banks, respectively, and by including a returning or paying bank's responsibility for indemnifying a Reserve Bank for indemnities it pays for returned checks. The proposed amendments also would move existing language from § 210.12(c)(2) about preservation of other warranties and liabilities to a separate paragraph (d), paralleling the creation of new § 210.5(b) with respect to preservation of forward warranties and indemnities.

Regulatory Flexibility Act

In accordance with section 3 of the Regulatory Flexibility Act (12 U.S.C. 605) and for the reasons stated below, the Board certifies that the proposed amendments to Regulation J if promulgated would not have a significant economic impact on a substantial number of small entities.

Under section 3 of the Small Business Act, as implemented at 13 CFR part 121, subpart A, a bank is considered a "small entity" or "small bank" if it has \$150 million or less in assets. Based on December 2003 call report data, the Board estimates that there are approximately 14,335 depository institutions with assets of \$150 million or less. The proposed amendments simply would provide that each bank that sends an electronic item

to a Reserve Bank for forward collection or return would make warranties and an indemnity for that item. The proposed new warranties and indemnity in Regulation J are similar to the warranties and indemnity that apply to substitute checks under the Check 21 Act. The proposed amendments would apply to all banks, regardless of size, that collect checks through a Federal Reserve Bank but the Board does not expect these amendments to impose economic costs on any such bank.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. The final rule contains no new collections of information and proposes no substantive changes to existing collections of information pursuant to the Paperwork Reduction Act.

12 CFR Chapter II

List of Subjects in 12 CFR Part 210

Banks, banking

Authority and Issuance

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR part 210 to read as follows:

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

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

Authority: 12 U.S.C. 248(i), (j), and (o), 342, 360, 464, 4001-4010, and 5001-5018.

§ 210.1 [Amended]

2. In § 210.1, add the phrase “the Check Clearing for the 21st Century Act (12 U.S.C. 5001-5018);” between the phrases “the Expedited Funds Availability Act (12 U.S.C. 4001 et seq.);” and “and other laws” in the first sentence.

§ 210.2 [Amended]

3. In § 210.2(h), in the second sentence remove the phrase “subpart C” and add the phrase “subparts C and D” in its place.

4. In § 210.2(i):

A. Redesignate paragraphs (i)(1), (i)(2), and (i)(3), as paragraphs (i)(1)(i), (i)(1)(ii), and (i)(1)(iii), respectively, and designate the text after the phrase “Item means” as paragraph (i)(1);

B. Remove the period at the end of newly-redesignated paragraph (i)(1)(iii) and add a semicolon followed by the word “and” in its place; and

C. After newly-redesignated paragraph (i)(1)(iii), add a new paragraph (i)(2) to read as follows:

* * * * *

(i) Item means –

* * * * *

(2) An electronic image of an item described in paragraph (i)(1) of this section, together with information describing that item, that a Reserve Bank handles pursuant to an operating circular. This type of item is referred to in this subpart as an electronic item.

* * * * *

5. In § 210.2(i), after paragraph (2), designate the undesignated paragraph with the word “Note” followed by a colon.

6. In § 210.2(l), revise paragraph (3) to read as follows:

* * * * *

(l) Paying bank means—

* * * * *

(3) The bank whose routing number appears on a check in the MICR line or in fractional form (or in the MICR-line information that accompanies an electronic item) and to which the check is sent for payment or collection.

* * * * *

7. Revise § 210.2(n) to read as follows:

* * * * *

(n) Sender means any of the following entities that sends an item to a Reserve Bank for forward collection—

(1) A depository institution, as defined in section 19(b) of the Federal Reserve Act (12 U.S.C. 461(b));

(2) A clearing institution, defined as—

(i) An institution that is not a depository institution but that maintains with a Reserve Bank the balance referred to in the first paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 342); or

(ii) A corporation that maintains an account with a Reserve Bank in conformity with § 211.4 of this chapter (Regulation K);

(3) Another Reserve Bank;

(4) An international organization for which a Reserve Bank is empowered to act as depository or fiscal agent and maintains an account;

(5) A foreign correspondent, defined as any of the following entities for which a Reserve Bank maintains an account: a foreign bank or banker, a foreign state as defined in section 25(B) of the Federal Reserve Act (12 U.S.C. 632), or a foreign correspondent or agency referred to in section 14(e) of that act (12 U.S.C. 358); or

(6) A branch or agency of a foreign bank maintaining reserves under section 7 of the International Banking Act of 1978 (12 U.S.C. 347d, 3105).

* * * * *

8. Remove the undesignated paragraph after § 210.2(o).

9. In § 210.2, add a new paragraphs (s) to read as follows:

* * * * *

(s) Unless the context otherwise requires-

(1) The terms not defined herein have the meanings set forth in § 229.2 of this chapter applicable to part 229, subpart C or D of this chapter, as appropriate; and

(2) The terms not defined herein or in § 229.2 of this chapter have the meanings set forth in the Uniform Commercial Code.

§ 210.3 [Amended]

10. In § 210.3(b) remove the phrase “subpart C” and add the phrase “subparts C and D” in its place; and

§ 210.4 [Amended]

11. In § 210.4(b)(1), remove the word “and” at the end of paragraph (iii), remove the period and add a semicolon followed by the word “and” at the end of paragraph (iv), and add a new paragraph (v) to read as follows:

* * * * *

(b) Handling of items.

(1) * * *

(v) The Administrative Reserve Bank of the bank to which a Reserve Bank sends or presents the item.

* * * * *

§ 210.5 [Amended]

12. In § 210.5(a):

A. Remove the word “and” at the end of paragraph (a)(2)(i);

B. Redesignate paragraph (3) as paragraph (5);

C. Revise paragraph (a)(2)(ii) and add new paragraphs (a)(2)(iii) through (a)(4) to read as follows:

(a) Sender’s agreement. * * *

(2) * * *

(ii) The item has not been altered; and

(iii) The item bears all indorsements applied by parties that previously handled the item for forward collection or return;

(3) Subject to the terms of part 229 of this chapter-

(i) Makes the applicable warranties set forth in § 229.34(c) of this chapter; and

(ii) If the item is a substitute check or a paper or electronic representation of a substitute check, makes the warranties and indemnity set forth in §§ 229.52 and 229.53 of this chapter;

(4) If the item is an electronic item that is not a representation of a substitute check, warrants to each Reserve Bank handling the item that—

(i) The item 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; replicates the MICR line of the original check, except for any changes required or permitted by part 229, subpart D of this chapter for substitute checks; and meets the technical requirements for sending electronic items to a Reserve Bank as set forth in the operating circulars; and

(ii) No party will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, the original item, or a paper or electronic representation of the electronic item such that the party will be asked to make payment based on an item it already has paid; and

* * * * *

13. In newly-redesignated § 210.5(a)(5):

A. In the first sentence remove the word “of” between the words “loss” and “expense” and add the word “or” in its place; and

B. Remove the word “or” between paragraphs (ii) and (iii);

C. Remove the period at the end of paragraph (iii) and add a semicolon in its place; and

D. Add two new paragraphs (5)(iv) and 5(v) to read as follows:

* * * * *

(iv) Any indemnity made by the Reserve Bank under § 229.53 of this chapter, as described in § 210.6(b)(2)(ii) of this subpart, if the sender sent a substitute check or a paper or electronic representation of a substitute check to the Reserve Bank; and

(v) Any indemnity made the Reserve Bank under § 210.6(b)(3)(ii) of this subpart, if the sender sent an electronic item that was not a representation of a substitute check to the Reserve Bank.

* * * * *

14. In § 210.5, redesignate paragraphs (b), (c), and (d) as paragraphs (c), (d), and (e), respectively, and add a new paragraph (b) to read as follows:

* * * * *

(b) Preservation of other warranties and indemnities. Nothing in paragraph (a) of this section limits any warranty or indemnity by a sender (or a party that handled an item prior to the sender) arising under state law or regulation or other federal law or regulation.

* * * * *

15. In paragraph (3) of newly-redesignated § 210.5(c), add the phrase “or indemnity” between the words “warranty” and “made.”

16. In newly-redesignated § 210.5(d):

A. In paragraph (1) remove the phrase “paragraph (b)” and add the phrase “paragraph (c)” in its place;

B. Designate the last sentence of paragraph (d)(2) as newly designated paragraph (d)(3);

C. In paragraph (d)(2) and newly-designated paragraph (d)(3), remove the phrase “paragraph (c)” wherever it appears and add the phrase “paragraph (d)” in its place; and

D. In newly-designated paragraph (d)(3) remove the phrase “paragraph (a)(3)” and add the phrase “paragraph (a)(5)” in its place.

§ 210.6 [Amended]

17. In § 210.6(a):

A. Redesignate paragraph (a)(2) as paragraph (a)(3);

B. Designate the third sentence of paragraph (a)(1) as paragraph (a)(2) and add the heading Limitations on Reserve Bank liability.; and

C. Redesignate paragraphs (a)(1)(i), (a)(1)(ii), and (a)(i)(iii) as paragraphs (a)(2)(i), (a)(2)(ii), and (a)(2)(iii), respectively;

D. In newly-designated paragraph (a)(2)(iii), remove the phrase “subpart C” and add the phrase “subparts C and D” in its place.

18. Revise § 210.6(b) to read as follows:

* * * * *

(b) Warranties and liability. The following provisions apply when a Reserve Bank presents or sends an item—

(1) The Reserve Bank warrants to a subsequent collecting bank and to the paying bank and any other payor that—

(i) The Reserve Bank is a person entitled to enforce the item (or is authorized to obtain payment of the item on behalf of a person who is either entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item);

(ii) The item has not been altered; and

(iii) The item bears all indorsements applied by parties that previously handled the item for forward collection or return;

(2) Subject to the terms of part 229 of this chapter, the Reserve Bank—

(i) Makes the applicable warranties set forth in § 229.34(c) of this chapter; and

(ii) If the item is a substitute check or a paper or electronic representation of a substitute check, makes the warranties and indemnity set forth in §§ 229.52 and 229.53 of this chapter; and

(3) If the item is an electronic item that is not a representation of a substitute check, the Reserve Bank—

(i) Warrants to the bank to which it transfers or presents the item that—

(A) The item 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; replicates the MICR line of the original check, except for any changes required or permitted by part 229, subpart D of this chapter for substitute checks; and meets the technical requirements for sending electronic items to a Reserve Bank as set forth in the operating circulars; and

(B) No party will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, the original item, or a paper or electronic representation of the electronic item such that the party will be asked to make payment based on an item it already has paid; and

(ii) Agrees to indemnify the bank to which it transfers or presents the item for the amount of any losses that the bank incurs under § 229.53 of this chapter for an indemnity

that the bank was required to make under § 229.53 in connection with a substitute check later created from the electronic item.

* * * * *

19. In § 210.6, redesignate paragraph (c) as paragraph (d) and add a new paragraph (c) to read as follows:

* * * * *

(c) Limitation on Reserve Bank liability. A Reserve Bank shall not have or assume any liability to the paying bank or other payor, except as provided in paragraph (b) of this section or for the Reserve Bank's own lack of good faith or failure to exercise ordinary care.

* * * * *

20. Revise newly-redesignated § 210.6(d) to read as follows:

* * * * *

(d) Time for commencing action against Reserve Bank. (1) A claim against a Reserve Bank for lack of good faith or failure to exercise ordinary care shall be barred unless the action on the claim is commenced within two years after the claim accrues. Such a claim accrues on the date when a Reserve Bank's alleged failure to exercise ordinary care or to act in good faith first results in damages to the claimant.

(2) A claim that arises under paragraph (b)(3) of this section shall be barred unless the action on the claim is commenced within one year after the claim accrues. Such a claim accrues as of the date on which the claimant first learns, or by which the claimant reasonably should have learned, of the facts and circumstances giving rise to the claim.

(3) This paragraph (d) does not lengthen the time limit for claims under section 229.38(g) (which include claims for breach of warranty under § 229.34 of this chapter) or part 229, subpart D of this chapter.

§ 210.12 [Amended]

21. In § 210.12(b)(1), remove the word "and" at the end of paragraph (iii), remove the period and add a semicolon followed by the word "and" at the end of paragraph (iv), and add a new paragraph (v) to read as follows:

* * * * *

(b) Handling of returned checks.

(1) * * *

(v) The Administrative Reserve Bank of the bank to which a Reserve Bank returns the returned check.

* * * * *

22. In § 210.12(c), redesignate paragraph (c)(3) as paragraph (c)(5), redesignate paragraph (c)(2) as paragraph (c)(3), revise newly-redesignated paragraph (c)(3), and add new paragraphs (c)(2) and (c)(4) to read as follows:

* * * * *

(c) Paying bank's and returning bank's agreement. * * *

(2) Warrants to each Reserve Bank handling a returned check that the returned check bears all indorsements applied by parties that previously handled the returned check for forward collection or return;

(3) Subject to the terms of part 229 of this chapter-

(i) Makes the applicable warranties set forth in § 229.34 of this chapter; and

(ii) If the returned check is a substitute check or a paper or electronic representation of a substitute check, makes the warranties and indemnity set forth in §§ 229.52 and 229.53 of this chapter; and

(4) If the returned check is an electronic item that is not a representation of a substitute check, warrants to each Reserve Bank handling the item that—

(i) The returned check 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; replicates the MICR line of the original check, except for any changes required or permitted by part 229, subpart D of this chapter for substitute checks; and meets the technical requirements for sending electronic items to a Reserve Bank as set forth in the operating circulars; and

(ii) No party will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, the original item, or a paper or electronic representation of the electronic item such that the party will be asked to make payment based on an item it already has paid; and

* * * * *

23. In newly-redesignated § 210.12(c)(5), revise paragraph (iii) and add new paragraphs (5)(iv) and (5)(v) to read as follows:

* * * * *

(iii) Any warranty made by the Reserve Bank under paragraph (e) of this section;

(iv) Any indemnity made by the Reserve Bank under § 229.53 of this chapter, as described in § 210.12(e)(1)(ii) of this subpart, if the returned check sent to the Reserve Bank was a substitute check or a paper or electronic representation of a substitute check; and

(v) Any indemnity made the Reserve Bank under § 210.12(e)(1)(iii) of this subpart, if the returned check sent to the Reserve Bank was an electronic item that was not a representation of a substitute check.

* * * * *

24. In § 210.12, redesignate paragraphs (d) through (i) as paragraphs (e) through (j), respectively, and add a new paragraph (d) to read as follows:

* * * * *

(d) Preservation of other warranties and indemnities. Nothing in paragraph (c) of this section limits any warranty or indemnity by a returning bank or paying bank (or a party that handled an item prior to that bank) arising under state law or regulation or other federal law or regulation.

* * * * *

25. Revise newly-redesignated § 210.12(e) to read as follows:

(e) Warranties by Reserve Bank. (1) The following provisions apply when a Reserve Bank handles a returned check under this subpart-

(i) The Reserve Bank warrants to the bank to which it sends the returned check that the returned check bears all indorsements applied by parties that previously handled the returned check for forward collection or return;

(ii) Subject to the terms of part 229 of this chapter, the Reserve Bank—

(A) Makes the returning-bank warranties in § 229.34 of this chapter; and

(B) If the returned check is a substitute check or a paper or electronic representation of a substitute check, makes the warranties and indemnity set forth in §§ 229.52 and 229.53 of this chapter; and

(iii) If the returned check is an electronic item that is not a representation of a substitute check, the Reserve Bank—

(A) Warrants to the bank to which it sends the returned check that—

(1) The item 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; replicates the MICR line of the original check, except for any changes required or permitted by part 229, subpart D of this chapter for substitute checks; and meets the technical requirements for sending electronic items to a Reserve Bank as set forth in the operating circulars; and

(2) No party will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, the original item, or a paper or electronic representation of the electronic item such that the party will be asked to make payment based on an item it already has paid; and

(B) Agrees to indemnify the bank to which it sends the returned check for the amount of any losses that the bank incurs under § 229.53 of this chapter for an indemnity that the bank was required to make under § 229.53 in connection with a substitute check later created from the returned check.

(2) A Reserve Bank shall not have or assume any other liability to any person with respect to a returned check except-

(i) As provided in paragraph (e)(1) of this section;

(ii) For the Reserve Bank's own lack of good faith or failure to exercise ordinary care as provided in subpart C of part 229 of this chapter; or

(iii) As provided in part 229, subpart D of this chapter.

* * * * *

26. In newly-redesignated § 210.12(f)(3), remove the phrase “Any warranty made by the Reserve Bank under 12 CFR 229.34,” and add the phrase “Any warranty or indemnity made by the Reserve Bank under paragraph (e) of this section,” in its place.

27. In newly-redesignated § 210.12(g):

A. In paragraph (g)(1), introductory text, remove the phrase “paragraph (d)” and add the phrase “paragraph (e)” in its place; and

B. Designate the last sentence of paragraph (g)(2) as paragraph (g)(3);

C. In paragraph (g)(2) and newly-designated paragraph (g)(3), remove the phrase “paragraph (f)” wherever it appears and add the phrase “paragraph (g)” in its place;

D. In newly-designated paragraph (g)(3), remove the phrase “paragraph (c)(3)” and add the phrase “paragraph (c)(5)” in its place.

§ 210.13 [Amended]

28. In § 210.13(b), remove the citation “§ 210.9(a)(5)” and add the citation “§ 210.9(b)(5)” in its place.

By order of the Board of Governors of the Federal Reserve System, June 4, 2004.

Robert deV. Frierson (signed)
Robert deV. Frierson
Deputy Secretary of the Board