FEDERAL RESERVE SYSTEM

12 CFR Parts 210 and 229

[Regulations J and CC; Docket No. R-1009]

Collection of Checks and Other Items by Federal Reserve Banks and Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Board requests comment on the benefits and drawbacks associated with its same-day settlement rule, which became effective in January 1994, and the implications of potential modifications of that rule to reduce or eliminate legal disparities between the Federal Reserve Banks and private-sector banks in the presentment and settlement of checks. The same-day settlement rule requires paying banks to provide same-day settlement for checks presented by private-sector banks by 8:00 a.m. local time at specified locations. The Board is evaluating the market experience under the same-day settlement rule and is considering further modifications to that rule pursuant to its responsibility under the Expedited Funds Availability Act to regulate the receipt, payment, collection, or clearing of checks in order to carry out the provisions of that Act and to improve the check collection system. The Board is also considering whether modifications to its Regulation J, subpart A, which governs check collection by the Federal Reserve Banks, to reduce or eliminate legal disparities would enhance the efficiency of the interbank check collection market, the check collection process, and the payments system more broadly.

DATES: Comments must be submitted on or before July 17, 1998.

ADDRESSES: Comments should refer to Docket R-1009 and may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Comments may also be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m. on weekdays, and to the security control room at all other times. The mail room and the security control rooms are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, N.W. Comments will be available for inspection and copying by members of the public in the Freedom of Information Office, Room MP-500, between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in Section 261.12 of the Board's Rules Regarding Availability of Information.

FOR FURTHER INFORMATION CONTACT: Louise Roseman, Associate Director (202/452-2789) or Jack Walton, Manager, Check Section (202/452-2660), Division of Reserve Bank Operations and Payment Systems; Oliver Ireland, Associate General Counsel (202/452-3625) or Stephanie Martin, Senior Counsel (202/452-3198), Legal Division. For the hearing impaired only, contact Diane Jenkins, Telecommunications Device for the Deaf (TDD) (202/452-3544).

SUPPLEMENTARY INFORMATION:

I. Overview

The Board is evaluating the extent to which its 1994 same-day settlement rule resulted in overall improvements to the check collection system and the payments system more broadly. The Board is undertaking this evaluation in the context of deciding whether other reductions in the legal disparities between Federal Reserve Banks and private-sector collecting banks in the check collection process might result in improvements to the check collection system or the payments system. These analyses are complex. As an initial matter, the Board expects that a reduction in the legal disparities between the Federal Reserve Banks and private-sector collecting banks generally should promote competition in the provision of check collection services. This competition should, in turn, promote efficiencies and spur innovation. Any such efficiencies, however, should be evaluated in the context of the potential effects that such changes may have on other participants in the check payment process. Thus, improved competition among collecting banks and the efficiency gains derived from this competition should be weighed against any increased costs to paying banks and their check-writing customers that could result from the changes. Further, the Board would evaluate whether increases in costs to paying banks and their check-writing customers represent unwarranted increases in the overall cost of the check payment system or a mere shift in costs from other check system participants to the drawer of the check, who generally is responsible for selecting the check as a medium of payment. Shifts in payment system costs in the direction of those responsible for selecting payment media generally may result in more efficient choices of payment media and therefore may be viewed as desirable in and of themselves.

The Board notes that removing legal disparities between Federal Reserve Banks and private-sector collecting banks associated with the presentment and settlement of checks would not result in a completely level "playing field" in the interbank check collection market. For example, the Reserve Banks enjoy an unsurpassable credit rating that makes them an attractive service provider in times of financial stress. They also labor, however, under constraints not imposed on their private-sector competitors, such as central bank concerns regarding the adequacy of payment services in the markets and cost recovery by major service category, as well as a level of public scrutiny of price and service level determinations not shared by the private sector. The Board will assess the desirability of further reductions in the legal disparities in the presentment and settlement of checks in the context of their effect on the overall competitive environment between the Federal Reserve Banks and private-sector collecting banks.

While the scope of this notice is limited to legal disparities between the Federal Reserve Banks and private-sector collecting banks in the presentment and settlement of checks, the Board expects to evaluate other possible regulatory changes that may have the potential to improve the efficiency and integrity of the nation's payments system and may request comment on them in the future. Further analysis is required before the Board may consider certain potential regulatory changes, however, such as changes to encourage electronic check presentment and truncation. As noted in the January 1998 report to the Board on The Federal Reserve in the Payments Mechanism (the Rivlin Committee Report), the Federal Reserve believes that, prior to considering regulatory changes that would foster the growth of electronic check presentment and truncation, it should first determine, together with other check collection system participants and users, their cost and feasibility. If this analysis concludes that electronic check presentment and truncation have substantial potential to increase the efficiency of the check system and that the requisite investment can be justified, the Board could work with other payments system participants to identify regulatory changes that would foster their growth.

II. Background

The Federal Reserve Banks generally have the right to receive same-day settlement in the form of a debit to a bank's account on the books of a Reserve Bank for checks they present to paying banks prior to 2:00 p.m. local time.[1 2 3] Effective January 1994, the Board amended its Regulation CC to include the so-called "same-day settlement rule." That rule requires paying banks to settle for checks presented by private-sector collecting banks on the day of presentment by credit to an account on a Reserve Bank's books (typically, Fedwire funds transfers) with no presentment fees if the checks are presented at the designated location of the paying bank by 8:00

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[1] 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. A "collecting bank" is a bank handling a check for collection, except the paying bank. A "correspondent bank" is an intermediary collecting bank that provides check collection services to other banks. A "presenting bank" is the collecting bank that presents a check to the paying bank. A "paying bank" generally is the bank by, at, or through which a check is payable.

[2] The Board adopted a policy in 1982 under which the Reserve Banks generally must present checks to paying banks located in Federal Reserve city availability zones by noon local time. (48 FR 79, January 3, 1983) This "noon presentment" policy, which provided for later presentment to city banks than was previously the case, was part of a broader program to expedite the collection of checks by establishing significantly later deposit deadlines and associated later presentment deadlines for checks drawn on city banks.

[3] The Federal Reserve Banks can obtain same-day settlement for checks presented to a paying bank before its cut-off hour of generally 2:00 p.m. or later. (12 CFR 210.9(b)(1); Uniform Commercial Code Article 4-108)

a.m. local time.[4] [5] (12 CFR 229.36(f)) Previously, some paying banks refused presentments from banks other than the Federal Reserve Banks, and other paying banks imposed presentment fees on private-sector presenting banks for the right to obtain same-day settlement or imposed other restrictions to presentment.

The Board's regulatory authority to adopt the same-day settlement rule is derived from the Expedited Funds Availability Act (EFAA). That Act gives the Board the responsibility to regulate “any aspect of the payment system, including the receipt, payment, collection, or clearing of checks, and any related function of the payment system with respect to checks” in order to carry out the provisions of the Act. (12 U.S.C. 4008(c)(1)) Prior to the enactment of the EFAA, the Board generally had authority only to regulate payments that were processed by Federal Reserve Banks.

The same-day settlement rule adopted by the Board was the culmination of two requests for public comment. In April 1988, the Board first requested comment on the concept of providing private-sector collecting banks presentment rights that were equivalent to those of the Reserve Banks, i.e., to obtain same-day settlement, without presentment fees, for all checks

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[4] The same-day settlement rule requires that settlement be made by the close of Fedwire on the business day the paying bank receives the check. (12 CFR 229.36(f)(2)) The scheduled closing time for Fedwire is 6:30 p.m. Eastern Time. Beginning on December 8, 1997, the Fedwire funds transfer system has opened at 12:30 a.m. Eastern Time (9:30 p.m. local time for west coast banks). Even though Fedwire re-opens on the same calendar day on the west coast, the Fedwire closing time and the settlement deadline under the same-day settlement rule will continue to be 6:30 p.m. Eastern Time (or 3:30 p.m. Pacific Time) for west coast banks.

[5] Under the Uniform Commercial Code, a private-sector presenting bank has a right to obtain same-day settlement for checks it presents by the paying bank’s cut-off hour of generally 2:00 p.m. or later. Unlike a Federal Reserve Bank, however, which obtains settlement by debit to a bank’s account on its books, a paying bank may settle with a private-sector collecting bank by credit to a Federal Reserve account or by cash. (UCC Article 4-108; 4-213(a)(1))

presented by 2:00 p.m. (53 FR 11911, April 11, 1988) The Board received 1,148 comments, 95 percent of which were opposed to the concept as proposed. Approximately 70 percent of commenters were businesses that believed that the 2:00 p.m. presentment deadline would severely disrupt, if not put an end to, corporate cash management and controlled disbursement services.[6] Generally, bank commenters echoed the concerns raised by businesses. In addition, banks expressed concern about the increased cost, operational complexity, and disruption that would be caused by the receipt of checks later in the day. Reserve Banks were concerned primarily that the rule would significantly erode their check collection volume and therefore would lessen their ability to exert leadership in improving the efficiency of the check system.

In light of the concerns raised by banks and their business customers in the response to its initial request for comment, the Board proposed in February 1991 a same-day settlement rule that reduced, but did not eliminate, the disparity in presentment rights between Reserve Banks and private-sector collecting banks. The revised proposal provided for an 8:00 a.m. local time presentment deadline for private-sector collecting banks. (56 FR 4743, February 8, 1991) While this proposal was supported by many correspondent banks and some other commenters, controlled disbursement banks and their business customers voiced continuing concerns.[7] In

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[6] Banks offering controlled disbursement services notify their corporate customers early in the day of the amount of the corporation's check payments that have been presented that day so that the corporation can invest surplus balances or borrow additional funds, as necessary, while money markets are still active. U.S. money markets become progressively less liquid after noon Eastern Time.

[7] Of the 291 commenters on this proposed rule, 130 opposed the proposal because of concerns related to the costs and operational burdens it may place on paying banks. Of the remaining commenters, 31 supported the proposal, 35 indicated support if suggested modifications were incorporated, 15 supported the Board's objectives to improve the check collection system but did not believe the proposal would achieve that objective, and 80 raised issues regarding the proposal but did not explicitly indicate whether they supported or opposed it.

October 1992, the Board adopted this rule in slightly revised form, effective January 1994. (57 FR 46956, October 14, 1992)

The same-day settlement rule that was adopted by the Board was designed to provide for more balanced bargaining power between presenting banks and paying banks by reducing the barriers to presentment that some paying banks previously imposed. The Board believed that the more balanced bargaining positions would improve payments system efficiency by (1) enhancing competition between private-sector banks and Reserve Banks in the provision of check collection services; (2) encouraging agreements between presenting banks and paying banks that would reduce the cost of the check system; (3) reducing inefficient intermediation in the check collection process; and (4) encouraging the migration of checks to more efficient payment mechanisms. At the same time, the rule was designed to address the concerns raised by large check drawers (i.e., businesses) and their banks that controlled disbursement arrangements not be unduly disrupted.

The Board requests comment on the effect the same-day settlement rule has had on the interbank check collection market, the check collection process, and the payments system more broadly. For example, this rule has resulted in a significant shift in check collection volume from the Federal Reserve Banks to private-sector correspondent banks or to direct presentments. Reserve Bank check volume has declined by 15 percent from 1993 to 1997, primarily due to changes in check collection patterns resulting from this rule. The Board assumes that collecting banks altered their check collection patterns in response to the same-day settlement rule in a manner that improved the efficiency of their collection process (by improving availability of funds and/or reducing the cost of collection). This improved efficiency in check collection must be weighed against additional costs the rule may have imposed on paying banks and their customers. The significant operational problems that large paying banks and their business customers believed would result from the adoption of the same-day settlement rule have not materialized to the Board's knowledge. The Board requests comment on the effect the rule has had on paying banks and their customers and on whether the rule has affected the choice of the payment mechanism used by payors.

The Board also requests comment on the benefits and drawbacks to potential further reductions in legal disparities. These changes include changes not only to the presentment deadline but also changes to the rules governing presentment location, the ability of the paying bank to impose reasonable delivery requirements, the control and timing of settlement, the obligation to settle on a non-banking day, and potentially other matters.

Commenters' overall perspectives on the issues raised in this notice, as well as their responses to the specific questions posed below, will be useful in the Board's analysis of the desirability of further regulatory changes. These questions are designed to stimulate comment on various aspects of the issues raised and should not be interpreted as the Board's views on these issues. Comments that provide quantitative data related to the costs and benefits of the current same-day settlement rule and of potential reductions in the remaining legal disparities would further assist the Board in its analysis of these issues. The Board recognizes that commenters may not be able to address each question that is posed; for example, banks may be in a better position to address certain issues while businesses may have more information regarding certain aspects of their payment practices.

III. Presentment Deadline

Today, assuming the same level of efficiency of check collection operations, the Reserve Banks are able to provide prompter availability than that provided by correspondent banks, in part because the Reserve Banks have the right to present checks with same-day settlement as long as six hours later than their correspondent bank competitors.[8] [9] Extending the current 8:00 a.m. presentment deadline for private-sector collecting banks in the same-day settlement rule to a later time should enable correspondent banks (1) to obtain settlement on some checks that they collect one day earlier than they do today (i.e., on those checks that can be presented by the later deadline but that could not be presented as early as 8:00 a.m.); (2) to better match the availability provided by the Reserve Banks on checks they do not now collect; or (3) to avoid presentment fees on some checks now presented after 8:00 a.m. Such an expansion, however, may increase costs incurred by paying banks and may make current controlled disbursement arrangements less attractive to business customers.

The Board requests comment on the benefits and costs of its 1994 same-day settlement rule and the likely effect of further reducing the disparity in presentment deadlines between the Reserve Banks and private-sector collecting banks. Questions regarding current market practices

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[8] In practice, Reserve Banks present most checks substantially earlier than 2:00 p.m. For example, in November 1997, more than 45 percent of the value of all checks were presented by the Reserve Banks by 10:00 a.m. Eastern Time (ET), nearly 60 percent were presented by 11:00 a.m. ET, and almost 75 percent were presented by noon ET.

[9] Although the Federal Reserve Banks have a later-in-the-day presentment deadline for forward collection checks than do private-sector banks, the Reserve Banks and private-sector banks are subject to the same deadline for the delivery of returned checks for same-day settlement. (12 CFR 229.32(b); 12 CFR 210.9(b)(1) and 210.12(h))

can be answered from an overall industry perspective or from the perspective of the organization providing comments.

A. Current bank market practices

1. What proportion of checks drawn on U.S. banks (in terms of volume and value) are (a) presented for same-day settlement by private-sector banks? (b) presented through clearinghouses? (c) presented by Federal Reserve Banks? (d) other? To what extent do these proportions vary from the proportions that were prevailing prior to the implementation of the same-day settlement rule? How many banks typically make and receive same-day settlement presentments?
2. Has the 1994 same-day settlement rule improved the speed and/or reduced the cost of collecting checks? Please explain.
3. Has the same-day settlement rule affected the number of banks that participate in check clearinghouses? Has it affected the volume of checks that are presented at clearinghouse exchanges?
4. To what extent has the same-day settlement rule affected the volume of checks that are collected by correspondent banks?
5. Do banks have agreements (other than clearinghouse agreements) that allow them to present checks after 8:00 a.m. and obtain settlement in same-day funds without presentment fees? If yes, how prevalent are these agreements? What offsetting benefits or considerations are provided to paying banks in the agreements? Are reciprocal late presentment privileges granted? Do the agreements impose any requirements for later

presentments, such as requiring transmission of MICR data?[10] How late can banks present checks for same-day settlement? What percentage of overall same-day settlement presentments do these later-in-the-day presentments represent?

6. Has the same-day settlement rule adversely affected paying banks' operations or risks? If yes, how? Has the rule affected the manner in which banks provide controlled disbursement and other corporate cash management services to their business customers? If yes, how? Are these effects significant?

B. Current business disbursement market practices

1. For what types of check payments (e.g., payroll, expense reimbursement, dividend, vendor, other) do businesses generally use controlled disbursement accounts?
2. To what extent do businesses make payments electronically, rather than by check? Do practices differ for specific types of payments (e.g., payroll, expense reimbursement, dividend, vendor, other)?
3. Has the same-day settlement rule adversely affected the ability of businesses to manage their disbursements effectively? If so, how?
4. Has the same-day settlement rule caused businesses to rely to a greater extent on internal forecasts of daily presentments to controlled disbursement accounts rather than on presentment totals provided by the paying bank?
5. Has the same-day settlement rule influenced businesses' decisions on whether to make payments by check or by other means? If so, how and why?

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[10] Magnetic Ink Character Recognition (MICR) data refer to the machine-readable information printed along the bottom of the check, and include the amount of the check, the routing number of the paying bank, and the account number of the drawer.

C. Effect of presentment deadline disparity on the ability of private collecting banks to compete with the Federal Reserve

1. To what extent does the disparity in the presentment deadlines of the Reserve Banks and private-sector collecting banks affect the ability of the correspondent banks to compete with the Reserve Banks in the interbank check collection market?

D. Effect of reducing or eliminating the presentment deadline disparity

1. Should the Board extend the presentment deadline for private-sector collecting banks? If so, to what time? What would be the latest presentment deadline that could be implemented for private-sector collecting banks without significantly disrupting cash management operations? without significantly disrupting paying bank operations? Please explain. What would be the implications to check depositors, collecting banks, check clearing houses, paying banks, and check drawers if the presentment deadline for private-sector banks were moved to 10:00 a.m.? noon? 2:00 p.m.? (See also question III.F.1.) Should this deadline apply to presentments by Federal Reserve Banks as well as to presentments by private-sector collecting banks? Why or why not?
2. Alternatively, should the Board impose an earlier presentment deadline on Federal Reserve Banks? If so, at what time? Should this deadline apply to presentments by private-sector collecting banks as well as to presentments by Federal Reserve Banks? Why or why not?
3. To what extent would an extension of the presentment deadline for private-sector collecting banks expedite the collection of checks? What categories of checks, if any (e.g., local checks, nonlocal checks drawn on RCPC endpoints, checks drawn on east

coast banks that are collected by west coast banks), would get collected faster if a later presentment deadline were established? To the extent that checks would be collected faster, would the cost of collection increase materially?

4. To what extent would a further reduction or elimination of differences in the presentment deadlines of Reserve Banks and private-sector collecting banks further improve decisions regarding the collection of checks by encouraging the use of the most efficient collection path?

5. What steps would businesses take to manage their payment disbursements if early-in-the-day presentment totals were not available from their banks? Would they rely on internal forecasting of the daily value of check presentments for some or all categories of payments? rely on electronic payments to a greater degree? shift their capital market activity to later in the day? Please explain. To what extent would these steps enable businesses to continue to manage their disbursements effectively?

E. Later-in-the-day presentment deadline conditioned on electronic transmission of check information

Some private-sector representatives and Reserve Banks have suggested that if the Board were to extend the presentment deadline for private collecting banks, it should condition the later deadline on the transmission of check MICR data by some earlier deadline.[11] Proponents of this approach believe that it would minimize any potential disruptions of a later presentment deadline on business cash management operations and may foster the ultimate acceptance of electronic

[11] Under this scenario, the delivery of the physical checks would continue to constitute presentment, absent an agreement between the presenting bank and paying bank.

check presentment. Others have expressed concerns that such an approach may be very cumbersome to impose by regulation and that paying banks that desire information regarding their check presentments earlier in the day can generally obtain this information by agreement with the presenting banks.

At the time the Board adopted the same-day settlement rule, it stated that "because the same-day settlement rule may induce agreements between paying banks and presenting banks that would allow for later presentment under certain conditions, the Board believes that it is preferable that market forces determine the development of private-sector response with respect to early electronic delivery. The Board will review the developments in the marketplace after this rule takes effect to determine whether further action may be necessary to encourage greater utilization of same-day settlement." (57 FR 46959, October 14, 1992)

1. If the Board were to condition a later-in-the-day presentment deadline for private-sector collecting banks on an earlier transmission of the MICR data on the checks to be presented, what would be the latest time the electronic transmission could be received by the paying bank without substantially disrupting cash management operations? What would be the latest presentment deadline for the physical checks that would not substantially disrupt paying bank operations? Explain.

2. If this approach were adopted, should the Board specify standards for the format and communication protocols for electronic transmission of the check information in Regulation CC? Would the benefits of simplicity and uniformity associated with mandated standards outweigh the negative effects on innovation that may result? If the Board were to specify these standards in regulation, what standards should be adopted? If

the regulation does not incorporate these standards, should the authority to dictate the technical specifications be vested with the presenting bank or the paying bank?

3. What responsibility should be placed on the paying bank to ensure sufficient communications capacity to accept transmissions of check information, including receipt of multiple transmissions sent shortly before the electronic transmission deadline? If the presenting bank is unable to transmit the information because it cannot establish a connection with the paying bank (due to contention for communications lines or an operating outage at the paying bank), should it still have the right to present the checks at the later-in-the-day deadline? What warranties, if any, should the presenting bank provide regarding the accuracy of the information that is transmitted?

4. If the Board were to adopt a later presentment deadline for private-sector collecting banks that was not conditioned on the transmission of the MICR-line information earlier in the day, to what extent would presenting banks be willing to provide this information by agreement to paying banks that desired it? Do commenters believe that such agreements could be obtained at a reasonable price?

F. Federal Reserve noon presentment policy

In conjunction with its review of potential modifications to its same-day settlement rule, the Board will also consider whether it should modify or rescind its 1983 policy that established a noon local time presentment deadline for checks presented by the Reserve Banks to paying banks located in Federal Reserve city availability zones. Historically, the Reserve Banks presented checks to members of city clearinghouse associations at the clearinghouse exchange, enabling the Reserve Banks to avoid transportation expenses that would be incurred by presenting checks to each clearinghouse member at its own facility. Following implementation of the noon presentment policy, some check clearinghouses moved their exchange to later in the morning, but generally not as late as noon. In most cases, the Reserve Banks have continued to present checks to city banks at the clearinghouse exchanges. Thus, although as a matter of policy banks located in Federal Reserve city zones are treated differently than banks located in other availability zones, in practice, the difference in treatment may be less significant than it appears, because the Reserve Banks currently present checks to most paying banks in RCPC and country zones by noon. Establishing a 2:00 p.m. presentment deadline for city paying banks would allow Reserve Banks to establish significantly later deposit deadlines for city checks, which would accelerate the collection of some checks drawn on these banks.

1. Should the Board modify or rescind its noon presentment policy for checks presented to banks in city availability zones? Why or why not?

<u>G. Effect of elimination of prohibition to pay interest on demand deposits</u>

Congress is considering legislative proposals that would remove the current restriction on the ability of banks to pay interest on demand deposits, most of which are held by businesses. The Board has supported the repeal of the prohibition on the payment of interest on demand deposits.

1. To what extent would the answers to the above questions be affected by a change in the law to permit banks to pay interest on demand deposits?
2. To what extent are controlled disbursement arrangements designed to minimize the interest earnings lost by holding funds in demand deposits? If banks paid an explicit

market rate of return on business demand deposits, would controlled disbursement arrangements be necessary?

IV. Other Legal Differences between the Federal Reserve Banks and Private Collecting Banks

In addition to the disparity in presentment deadlines, there are other legal differences in the abilities of the Federal Reserve Banks and private-sector banks to collect checks. The Board requests comment on the continued justification of these legal differences, the effect of reducing or eliminating these legal differences on the efficiency and integrity of the interbank check collection market, the check collection process, and the payments system more broadly, and, if the Board were to modify these regulatory provisions, how it should do so.

A. Presentment location for same-day settlement

The Reserve Banks have greater flexibility than private-sector collecting banks have under the same-day settlement with respect to the locations to which they may present checks to a paying bank. Under the same-day settlement rule, a presenting bank must present a check to the paying bank "at a location designated by the paying bank. . . in the check-processing region consistent with the routing number encoded in magnetic ink on the check." (12 CFR 229.36(f)(1)(i)) If the paying bank does not designate a presentment location, then the presenting bank may present the check to any location described in § 229.36(b). In contrast, the paying bank does not have the legal right to designate a single location to which checks must be presented by a Federal Reserve Bank. The Board's Regulation J, which governs check collection by the Federal Reserve Banks, does not limit the permissible presentment location to that designated by the paying bank. Instead, it provides the Federal Reserve Banks flexibility, including the right to present checks to any location specified in § 229.36(b) of Regulation CC or to present checks through a clearinghouse, subject to its rules and practices. (12 CFR 210.7(b)) In practice, however, the Reserve Banks generally present checks to the location designated by the paying bank consistent with the routing number on the check.

1. To what extent does this disparity in permissible presentment locations affect the ability of private-sector banks to compete effectively with the Reserve Banks in the interbank check collection market? In practice, to what extent and why do paying banks designate a presentment location for presentments made under the same-day settlement rule that differs from the presentment location used by the Federal Reserve Bank?
2. Should the Reserve Banks and private-sector collecting banks be subject to the same rules regarding presentment locations for check presented for same-day settlement? Why or why not?
3. If the Board were to eliminate the disparity regarding permissible presentment locations, should it make the flexibility currently provided to the Reserve Banks in Regulation J available to private-sector collecting banks or impose on the Reserve Banks the standard currently applicable to private-sector collecting banks?

<u>B. Ability of paying bank to impose reasonable delivery requirements</u>

Under the same-day settlement rule, a paying bank must settle for a check on the day of presentment “if the presenting bank delivers the check in accordance with reasonable delivery requirements established by the paying bank.” (12 CFR 229.36(f)(1)) The Commentary to this section notes that because presentment may not take place during the paying bank's banking day, a paying bank may establish reasonable delivery requirements to safeguard the checks presented.

Regulation J provides no similar right to paying banks to establish reasonable delivery requirements for Federal Reserve Bank presentments.

1. What types of delivery requirements are imposed by paying banks for presentments by private-sector collecting banks for same-day settlement?
2. To what extent does the disparity in the right to impose reasonable delivery requirements affect the ability of private-sector banks to compete effectively with the Reserve Banks in the interbank check collection market?
3. Should paying banks have the same right to impose reasonable delivery requirements on the Federal Reserve Banks as they have on private-sector presenting banks? Alternatively, should the paying banks' right to impose reasonable delivery standards on private-sector banks be eliminated? Why or why not?
4. If paying banks had the right to impose reasonable delivery requirements on Federal Reserve Bank presentments, would banks require the Reserve Banks to modify their current presentment practices? If so, how?

C. Control of settlement

The manner in which settlement of Federal Reserve-presented checks is made differs significantly from the manner in which settlement for checks presented by private-sector collecting banks is made. While the Federal Reserve controls the settlement of checks it presents, the paying bank controls the settlement of checks presented by private-sector banks. In the case of checks presented by the Federal Reserve Banks, the Reserve Bank debits the account of the paying bank or its designated correspondent on its books. (12 CFR 210.9(b)(5)) In contrast, the paying bank settles for checks presented by a private-sector bank for same-day settlement by sending a Fedwire funds transfer to the presenting bank or by another agreed-upon method. (12 CFR 229.36(f)(2))

1. To what extent does this disparity in the control of the settlement affect the ability of private-sector banks to compete effectively with the Reserve Banks in the interbank check collection market?

2. Should the Board take steps to reduce or eliminate this disparity? If so, why and how? For example, should the Board eliminate the Reserve Banks' ability to autocharge (i.e., automatically debit the account of the paying bank)? Alternatively, should presenting banks have more control over the settlement of checks presented for same-day settlement? If yes, how could this best be accomplished?

D. Time of settlement

In the case of presentments for same-day settlement by both Federal Reserve Banks and private-sector collecting banks, the paying bank becomes accountable for a check if it does not settle for the check by the close of Fedwire on the day of presentment. (12 CFR 210.9(b)(1) and 12 CFR 229.36(f)(2)) The Reserve Banks, however, have the right to debit the account of the paying bank for settlement of checks by the latest of (a) the next clock hour that is at least one hour after the paying bank receives the check, (b) 9:30 a.m. Eastern Time, or (c) such later time provided in the Reserve Bank's operating circular. (12 CFR 210.9(b)(2))

The Board noted, when it adopted the same-day settlement rule, that it believed that, at the present time, the settlement time for checks presented by private banks should not conform to the settlement time for checks presented by Reserve Banks under Regulation J. The Board reached that conclusion after considering the reasoning put forth by the commenters to the proposed rule as well as the fact that conforming the two times would (a) create the additional burden for the paying bank of initiating early-in-the-day Fedwire transfers for private-sector presentments (as opposed to settlement payments to Reserve Banks, which are made by debits to accounts held by the Federal Reserve and require no affirmative action by the paying bank); (2) result in an increased potential for mistakes, even if the deadline were met; and (3) increase the risk faced by paying banks that may want to examine selected cash letters presented by certain banks. The Board noted, however, that it would revisit the issue of settlement deadlines for checks presented by private-sector collecting banks under the same-day settlement rule if intraday funds start to have significant value as a result of Federal Reserve pricing of daylight overdrafts. (57 FR 46964, October 14, 1992) To date, this has not occurred.

1. To what extent does this disparity in the timing of the settlement affect the ability of private-sector banks to compete effectively with the Reserve Banks in the interbank check collection market?
2. Have there been any changes in the marketplace or other considerations that should change the Board's earlier conclusion regarding this issue? If yes, please explain.
3. Instead of requiring earlier-in-the-day settlement for same-day settlement presentments by private-sector collecting banks, the Board could also reduce the legal disparity in the timing of settlement by moving the paying banks' settlement to Federal Reserve Banks to the close of Fedwire. If such a change were made, the Reserve Banks would also provide credit for check deposits at the same time. Would this approach be desirable? Why or why not?

E. Obligation to settle on a non-banking day

The settlement obligation of a paying bank that closes voluntarily on a business day (i.e., a day that the Federal Reserve Banks are open) differs depending on whether the Federal Reserve Bank or a private-sector collecting bank is the presenting bank. In the case of the Federal Reserve Bank, the paying bank's settlement obligation is triggered if the Reserve Bank "makes a cash item available to the paying bank on that day." (12 CFR 210.9(b)(3)) In the case of a presentment made by a private-sector collecting bank, the paying bank's settlement obligation is triggered only if the paying bank "receives presentment of a check" on a business day on which it is open. (12 CFR 229.36(f)(3)) A paying bank that is obligated to settle for checks presented on a day that it is closed is not considered to have received the checks until its next banking day for purposes of the deadline for return.[12]

1. To what extent does this disparity in the settlement obligation of a closed paying bank affect the ability of private-sector banks to compete effectively with the Reserve Banks in the interbank check collection market?
2. Should the paying bank's obligation to settle on days on which it closes voluntarily be the same for presentments by the Federal Reserve Banks and private-sector collecting banks? If so, what standard should be used and why?

<u>F. Other legal differences</u>

1. Are there additional legal differences between the rights and obligations associated with checks presented by the Federal Reserve Banks and private-sector collecting banks? If

[12] If a Federal Reserve Bank makes a cash item available to a paying bank on a day that it closes voluntarily, the paying bank must either settle for the item on that day or on the next banking day with an as-of adjustment or other interest compensation. If a private-sector bank presents a check to a paying bank for same-day settlement on a day that it closes voluntarily, the paying bank must settle by its next banking day and pay interest compensation.

so, please describe. To what extent do these other differences affect the ability of private-sector banks to compete effectively with the Reserve Banks, or the ability of Reserve Banks to compete effectively with other presenting banks, in the interbank check collection market? What changes, if any, should the Board consider to minimize or eliminate these differences?

V. Consistency of Reduction in Legal Disparities with Purposes of the Expedited Funds Availability Act

The Board's authority to govern the collection of checks through private-sector banks is derived from the Expedited Funds Availability Act. Therefore, amendments to Regulation CC, subpart C should be consistent with the Act's purpose to provide timely availability of funds deposited into transaction accounts; this is generally accomplished by accelerating the collection and/or return of checks. To the extent that unpaid checks are returned to the depositary bank more expeditiously, the depositary bank can make the funds available to its customer for withdrawal on a more timely basis without assuming greater risk.

In contrast, the Board's authority to govern checks collected through the Federal Reserve Banks is derived from the Federal Reserve Act and not the Expedited Funds Availability Act. Consequently, the Board's authority to amend Regulation J, subpart A, is not limited to changes that accelerate the collection and/or return of checks. Nonetheless, the Board has generally regulated the collection of checks through the Federal Reserve Banks in a manner that provides for their timely collection and return.

1. Should the Board consider changes to Regulation J that would reduce the legal disparities between the Federal Reserve Banks and private-sector collecting banks, if those changes slow the collection and return of checks through the Reserve Banks and therefore are not consistent with the purpose of the Expedited Funds Availability Act?

By order of the Board of Governors of the Federal Reserve System, March 10, 1998.

Jennifer J. Johnson,
Deputy Secretary of the Board.